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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

COMPLETED

ORIGINAL

Treasury Should Keep Better Track Of Blocked Foreign Assets

The Treasury Department, under emergency legislation, blocks the assets of designated countries hostile to the United States to prevent these countries from earning dollar foreign exchange and from using the assets until political differences are resolved and American claims settled.

The Office of Foreign Assets Control regulates the blockings but relies almost entirely on private financial institutions to carry them out. It does not routinely determine what assets are blocked nor how custodians account for them and preserve their value on behalf of American claimants. Such determinations are exceptional, as is the President's order to take a census of Iranian assets and U.S. claims against Iran.

In addition, not enough attention has been given to protecting U.S. Government interests affected by the blockings.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-199288

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses Treasury's need to obtain better information and to monitor more closely foreign assets blocked pursuant to executive emergency authority. It also describes how such assets have been used to settle American claims with the affected countries and suggests steps to protect U.S. Government interests in blocked property.

Recent legislation has limited the President's use of emergency authority to regulate international financial transactions, but the blocking of foreign assets remains an integral and increasingly significant part of U.S. trade controls. Except for a review of Rhodesian sanctions in 1977, we have not previously examined the administration of U.S. blocking controls.

We are sending copies of this report to the Director, Office of Management and Budget; Secretaries of Agriculture, State, and the Treasury; and Administrator, Agency for International Development.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

TREASURY SHOULD KEEP BETTER TRACK OF BLOCKED FOREIGN ASSETS

D I G E S T

The Treasury Department, through the Office of Foreign Assets Control, regulates commercial and financial transactions with countries hostile to the United States by

--restricting trade with such countries and their nationals and

--blocking their assets which are located in the United States or under U.S. jurisdiction.

The restrictions seek to prevent designated hostile countries from acquiring dollar foreign exchange and to deny them the free use of their assets until political differences are resolved and American claims are satisfied. While Treasury has improved its administration of the controls, as exemplified by its handling of the Iranian asset freeze, more needs to be done.

The controls which currently freeze the assets of Cambodia, Cuba, Czechoslovakia, East Germany, North Korea, Vietnam, and the Baltic States are based on the Trading With the Enemy Act, an emergency statute employed by President Truman against the People's Republic of China and North Korea in response to the global threat of Communist aggression. Under more recent emergency economic powers legislation, President Carter has determined that these controls should continue until American claims and political differences against these countries are settled. He also ordered Iranian Government assets frozen in November 1979.

Treasury officials cite this "emergency" rationale, a Government policy of noninterference in owner investment discretion, and administrative cost considerations as reasons for not keeping close track of the assets or monitoring asset-holder practices. Under these circumstances, Treasury cannot ensure that its controls are effective or that the interests of American claimants and the U.S. Government are being adequately protected.

Tear Sheet. Upon removal, the report cover date should be noted hereon.

GAO does not doubt that the Treasury blocking controls have immobilized substantial amounts of foreign assets or that these assets provide useful leverage in obtaining claims compensation for expropriated American property. However, what does concern GAO is whether the system for implementing blocking controls and Treasury's monitoring of the controls are adequate to assure that designated hostile countries are denied the use of their dollar assets and earnings to the maximum practicable extent, that blocked assets are properly accounted for and their value preserved, and that a reliable basis exists on which to make policy and management decisions regarding the assets and related U.S. interests.

TREASURY KNOWLEDGE OF ASSETS AND ASSET-HOLDER PRACTICES DEFICIENT

Treasury administrators have not required asset-holders to systematically report the assets they block or receive custody of nor have they regularly inventoried the assets or monitored the holders to determine how the assets are identified and kept. As a result, the administrators frequently did not know what assets were blocked, who owned them, where they were located, or what they were worth. This lack of asset knowledge and virtually complete dependence on asset-holders made Treasury unable to fully assess the program's effectiveness, give information on the assets' worth, and provide assurances that they were properly accounted for and managed. Furthermore, there were compelling reasons for Treasury to keep better track of the blocked assets and to monitor the asset-holders' blocking and custodial practices. For example:

--Census data on blocked Chinese assets could not be reconciled. An $80.5 million claims settlement negotiated with the People's Republic of China in 1979 on the basis of an updated 1970 census excluded consideration of assets worth more than $10 million when they were blocked in 1951 because they could not be found. (See p. 11.)

--Treasury's estimate of $140 million in blocked Vietnamese assets, based on a 1976 survey and presented in congressional testimony in July 1979, was significantly overstated. The estimate contained a $21 million bank "double-counting" error, $40 million in third-country bank funds subject to litigation, and an unknown value representing licensed and unauthorized unblockings. (See p. 12.)

--Treasury's recordkeeping of blocked assets left much to be desired. It lacked a complete and current inventory of blocked assets and its files were poorly organized and maintained, thus severely reducing the effectiveness of administration and oversight. (See p. 16.)

--Amid the absence of any regular Treasury monitoring of asset-holders, there were indications that the holders were neither complying with prescribed recordkeeping requirements nor too concerned with protecting asset values. (See p. 16.)

GAO believes it is essential for Treasury to keep informed about what assets have been blocked and their current status. The cost of doing so need not be prohibitive. Not only does the U.S. Government have a responsibility to keep track of the assets but also their values--blocked as well as realizable--have been important determinants in the size of claims settlements and a source of compensation paid in these settlements.

RECOMMENDATIONS

GAO recommends that the Secretary of the Treasury:

--Conduct a comprehensive census of existing blocked assets and keep it up to date through periodic asset-holder reports of new blockings, transfers, other dispositions, and status of assets in custody. (see p. 17.)

--Establish and maintain blocked asset master control records and use the status reports and control records to identify potential problem areas for followup. (See p. 17.)

--Seek the cooperation of other Federal and State regulatory agencies to perform such tests of asset-holder procedures or verify such data as may be considered appropriate. (See p. 24.)

OTHER ISSUES AND TREASURY ACTIONS NEEDED

The President has taken various steps in recent years to relax the Treasury controls. In view of this trend and the cost-benefit relationship which may exist on small value assets, GAO recommends that a minimum amount be set for blocking assets. (See p. 32.)

Blocked assets are turned over to State abandoned property offices as they receive custodial authority. GAO believes such transfers unnecessarily jeopardize owner and Treasury interests in the assets and recommends that authority for the practice be terminated. (See p. 34.)

Asset-holders contacted by GAO did not appear to possess a clear understanding of Treasury regulations. Therefore, GAO advises supplementary monitoring of asset-holders to determine whether the regulations have been received and are understood. (See p. 26.)

Treasury has shown belated concern in maintaining asset values. It was not until 1979, when Treasury revised its regulations to require that deposits be held in interest-bearing accounts, that any positive steps were taken to protect blocked asset values from being eroded by inflation. Although the exact magnitude of assets affected by this change is not known, it is substantial. If the Chinese assets which were held in non-interest-bearing demand accounts since 1950 had been placed in interest-bearing accounts when they were blocked, the yield would have been sufficient to compensate for the full principal value of private American claims rather than the less than 40 cents on the dollar actually realized absent consideration of inflation and interest. (See p. 33.)

MORE ATTENTION NEEDED ON U.S. GOVERNMENT INTERESTS

Significant amounts of U.S. Government-funded assets were tied up in the blocking of Vietnamese and Cambodian assets when these countries fell to the Communists in 1975. GAO was instrumental in the recovery of $7.9 million in blocked Defense Department funds and is making recommendations that may lead to other recoveries and prevent future blocking of assets funded by U.S. agencies. For example, GAO recommends that:

--Federal agencies support the Agency for International Development in recovering $1.4 million or more representing the unexpended portion of the U.S. contribution to the Cambodia Exchange Support Fund. (See p. 51.)

--A prior GAO recommendation be reconsidered which, if adopted, would avoid the entrapment of Public Law 480 goods in future blockings. (See p. 47.)

U.S. Government claims, which are largely undetermined, do not compete with private claims for compensation generated from settlements negotiated and funded by blocked assets. GAO believes this weakens the prospects for recovery of Government claims. It recommends that the Department of State determine claims against Vietnam and other countries and include these claims in any assets-funded settlement. (See p. 57.)

AGENCY COMMENTS AND GAO EVALUATION

The Treasury Department, which has primary responsibility for foreign blocked asset management, said that while the draft report contained useful observations it did not adequately describe steps already taken by Treasury in connection with, and incidental to, implementation of the Iranian sanctions which would eliminate or minimize the problems. The report has been updated and revised to reflect Treasury's actions following the blocking of Iranian assets. (See app. III.)

The State Department agreed that the full extent of claims against blocked countries should be determined and, as GAO is also recommending, that certain Government claims be given priority against matching assets. It disagreed that Government claimants should otherwise participate in assets-funded settlements because of the difficulty of concluding them on terms acceptable to affected private claimants and the Congress. GAO rejects this rationale since it leaves Government claimants in a subordinated creditor position to private claimants. (See app. IV.)

The Agency for International Development generally agreed with GAO's recommendations concerning identification and recovery of U.S. Government claims and interests. The Agriculture Department did not agree to reconsider GAO's prior recommendation aimed at avoiding entrapment of Public Law 480 commodities, but offered no new rationale to buttress its earlier position that existing safeguards were adequate. (See apps. V and VI.)

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ABBREVIATIONS

AID	Agency for International Development
ESF	Exchange Support Fund
GAO	General Accounting Office
OFAC	Office of Foreign Assets Control
OPIC	Overseas Private Investment Corporation
PRC	People's Republic of China

CHAPTER 1

INTRODUCTION

The Treasury Department, through the Office of Foreign Assets Control (OFAC), regulates commercial and financial transactions with designated countries hostile to the United States. It does so by restricting trade with such countries and their nationals and by blocking their assets which are located in the United States or under U.S. jurisdiction. The restrictions seek to prevent hostile countries from acquiring dollar foreign exchange and to deny them the free use of their assets until political differences are resolved and American claims are satisfied. Blocking or "freezing" of assets applies to any property subject to U.S. jurisdiction in which a particular country or its national has an interest, unless the property is authorized to be released by the Treasury Department. Title to blocked property remains with the designated foreign country or national and possession is retained by whoever was the holder (usually a banking institution) when the blocking order took effect. Blocked property, which is mostly in the form of bank deposits and securities, may be converted in form or transferred to another institution at the owner's discretion so long as it is not removed from the blocking controls.

LEGAL AUTHORITY

The blocking controls administered by the Treasury Department predominantly have been based on Section 5(b) of the 1917 Trading With the Enemy Act, as amended. The section authorizes the President, in time of war or national emergency, to regulate a broad range of domestic and international financial transactions and to prohibit or regulate any property transaction in which a foreign country or foreign national has any interest. Through use and amendment, Section 5(b) has evolved into an essentially unlimited grant of authority for the President to exercise those broad powers without congressional review. It is the basis for four of the five existing blocking regulations, the exception being those applied to Iran.

Blocking controls have also been applied using other authorities. Sanctions on trade with Rhodesia, which were first issued in 1967 and expanded in 1968 in accord with U.N. Security Council resolutions, were terminated in December 1979. In November 1979, the President cited new emergency economic powers legislation in blocking the Iranian Government's assets to protect American investments in Iran.

Concern by Congress over the executive branch's continuing use of the Trading With the Enemy Act and other emergency statutes in regulating domestic and international economic transactions culminated in enactment of the National Emergencies Act in 1976. This Act repealed most emergency statutes (one exception being Section 5(b) of the Trading With the Enemy Act); provided that related Presidential powers and authorities were to be terminated within 2 years; established criteria for the declaration, conduct, and termination of future emergencies; and set forth accountability and reporting requirements. Section 5(b) was specifically exempted, subject to study and recommendations by relevant congressional committees, because of potentially serious adverse consequences which would result from its termination.

Following an examination into the use of Section 5(b), the Chairman, Subcommittee on International Economic Policy and Trade, House Committee on International Relations, commented in June 1977 that:

> "Section 5(b) has become a grab-bag of authorities which Presidents have been able to use to do virtually anything for which they could find no specific authority."

The House Committee considered carefully whether to revise the existing controls and policies in proposed new legislation. It decided, however, that combining current uses of existing authorities with improvements in policies and procedures which would be applicable during future national emergencies would be difficult and divisive to administer. Thus, although acknowledging that existing policies were controversial and enabled possible abuses, the Committee chose to preserve the existing uses of the Section 5(b) powers without endorsement or disclaimer, subject to an annual determination by the President that its continued use is in the national interest.

The Committee recommended a new set of authorities suggested by the Administration for use in future national emergencies. These were more limited in scope than Section 5(b) and subject to strict procedural limitations, including consultation with Congress, periodic reporting requirements, and provision for termination. These redefinitions of the President's power to regulate international economic transactions were incorporated into the International Emergency Economic Powers Act in December 1977. Except for "grandfathering" the freezing controls which existed under Section 5(b) prior to the 1977 Act, these redefinitions removed the President's authority to invoke the Trading With the Enemy Act in times of national emergency. After 1977, the President's powers to regulate international economic transactions in a national emergency are derived solely from the International Emergency Economic Powers Act.

Consistent with these authorities, the President determined on September 8, 1978, and each year since then, that the blocking regulations being administered under Section 5(b) were in the national interest and should be extended for one year. In making these determinations, the President stated that the lapse of these authorities would be unacceptable in the light of U.S. foreign policy objectives.

BLOCKING REGULATIONS

The controls are embodied in five sets of regulations. The foreign assets, Cuban assets, and foreign funds control regulations relate primarily to blocking, with the aim of facilitating the resolution of private American claims. The transaction controls, instituted in 1953, supplement Department of Commerce export controls designed to restrict the flow of strategic goods to Communist countries. The 1977 International Emergency Economic Powers Act was used to freeze the assets of the Government of Iran.

The blocking regulations administered by OFAC have common objectives, scope, and application. Each sets forth broad prohibitions against a wide range of property transfers and financial dealings. In addition, OFAC is empowered to license transactions, granting exceptions to the blanket prohibitions when it determines this is in accord with national policy.

Foreign assets control

These regulations were issued in December 1950 following the entry of the People's Republic of China (PRC) into the Korean War and were applied to both the PRC and North Korea. As set forth in President Truman's proclamation of emergency, the principal objective of the U.S. blocking was to contain the worldwide spread of Communist imperialism in Korea and elsewhere. Although the specific crisis to which the proclamation applied had long since ceased to exist, OFAC used this emergency authority to block the assets of PRC and North Korea and to exercise political controls on all blocked assets and restricted dollar transfers until the emergency was terminated by the 1976 National Emergencies Act. On the basis of the 1950 emergency declaration, the foreign assets control regulations were amended in 1964 to apply to North Vietnam and in 1975 to include Cambodia and Vietnam. Assets in which the PRC or its nationals have an interest were unblocked on January 31, 1980.

The regulations block all assets within U.S. jurisdiction in which these countries or their nationals have any interest, prohibit the purchase or import of their goods by Americans, provide third-country export restrictions, and prohibit the use of U.S. financial and commercial facilities in transactions with these countries or their nationals, except as authorized by OFAC licensing.

Cuban assets control

These regulations, issued in 1963, superseded less comprehensive controls on Cuban imports imposed the previous year. The 1963 regulations imposed an almost complete embargo on trade and financial transactions. In October 1975, the embargo was eased to permit foreign firms owned or controlled by U.S. citizens to trade in nonstrategic goods with Cuba under certain conditions. Direct U.S. trade with Cuba remains prohibited and its assets continue to be frozen. Aside from subsidiary trade policy, the regulations differ in only minor respects from the foreign assets controls.

Foreign funds control

These regulations continue to block the property of Czechoslovakia and East Germany pending claims settlements for the illegal expropriation of private American property following World War II. They also continue to block assets of the Baltic States (Estonia, Latvia, and Lithuania) as a reflection of the U.S. policy of nonrecognition of the forceable incorporation of these countries into the Soviet Union.

Iranian assets control

These regulations block the assets of the Iranian Government but not of the country's nationals as the other regulations do. The freeze, effective November 14, 1979, followed an Iranian threat to withdraw its funds from U.S. banks and was taken as a precautionary measure to protect U.S. investments in Iran and to calm the foreign exchange markets in the wake of the seizure of the U.S. Embassy and American citizens in Tehran. On April 7, 1980, the regulations were amended to provide for a census of blocked assets and of claims by U.S. persons against Iran, and to implement expanded economic sanctions against Iran.

OFFICE OF FOREIGN ASSETS CONTROL

OFAC issues the regulations directly to financial institutions or notifies them through publications and the mass media.

It also maintains a staff in Washington, D.C., and New York City to assist with interpretations, license policymaking, and enforcement.

The forerunner to OFAC came into existence under authority of Section 5(b) of the Trading With the Enemy Act as a Foreign Funds Control office during Germany's conquest of Norway in 1940 through delegation of the President's powers to the Secretary of the Treasury. The initial purpose was to freeze the funds held in the United States of conquered countries to avoid the forced repatriation and confiscation of these assets by German administrators. The office developed other functions as the war expanded, ranging from restriction of foreign trade and financial operations to outright economic warfare. At the height of World War II, its activities encompassed most of the countries of the world and affected assets valued at over $7 billion. The end of the war was followed by a rapid phaseout of controls. In 1947, the residual staff and functions were transferred to the Office of Alien Property in the Department of Justice, which administered the blocked assets until 1966 when it was abolished and this function transferred back to Treasury and the Office of Foreign Assets Control.

OFAC, serving much the same purpose as the Foreign Funds Control office, was established in December 1950 during the Korean War. The succession of international crises since then has resulted in controls being applied against many countries. After nearly three decades, however, OFAC's operating approach remains closely tied to U.S. foreign policy decisions and considerations which have grown out of these emergencies.

EFFECTS OF CONTROLS

The precise magnitude of the assets blocked is not known. Although all assets, regardless of type or size, in which a designated national has an interest are subject to the controls, custodians do not routinely report the results of blockings to OFAC. OFAC has conducted censuses of blocked assets for only three countries, China and North Korea in 1951 (China's was updated in 1970) and Cuba in 1964. A census of blocked Iranian assets and U.S. claims against Iran commenced in April 1980. (See app. I.) In addition, OFAC made a limited informal survey of Vietnamese assets in 1976, shortly after they were blocked.

OFAC estimates that the value of the foreign assets blocked as of yearend 1979 were as follows.

Country	Estimated value (000 omitted)
Cambodia	$ 9,000
China	a/80,500
Cuba	30,000
Czechoslovakia	1,400
East Germany	700
Estonia	5,800
Iran	8,000,000
Latvia	9,200
Lithuania	2,600
North Korea	Negligible
Vietnam	140,000

a/These assets were unblocked on Jan. 31, 1980.

Similarly, other asset data, such as type, owner, location, and realizable value, needed for claims settlement purposes were also incomplete. Based on the China and Cuba censuses and subsequent surveys, the major portion of blocked assets are deposits in domestic banks and foreign branches and subsidiaries of U.S. banks; in U.S. Treasury and Federal Reserve accounts; and in dollar-denominated securities of various forms. Except for Iran, whose blocked assets were all government-owned or controlled, the ownership of the remainder was divided among government entities, third-country banks, individuals, corporations, and others. Adverse claims and other interests affecting the realizable value of blocked property were known only to the extent they were identified in the censuses.

BLOCKED ASSETS USED TO BRING ABOUT CLAIMS SETTLEMENTS

Blocked assets can and have played an important role in the negotiation and settlement of American claims arising from nationalization or other unlawful takeover of property. For example, payment of claims for post-World War II settlements with Bulgaria, Hungary, and Romania were funded from the vesting and liquidation of assets blocked by the United States.

A claims settlement agreement concluded in May 1979 between the United States and the PRC provides for payment of $80.5 million to the United States in consideration of the unblocking of all assets in which the PRC or its nationals had an interest. The amount to be paid by the PRC, in installments through October 1, 1984, corresponds exactly with the official U.S. estimate of the blocked assets' value at the time the agreement was signed.

The Foreign Claims Settlement Commission has certified claims of U.S. nationals against the PRC totaling $196.9 million, and is still considering a small amount of claims for losses between 1966 and 1979. After a 5-percent statutory deduction for U.S. Government administrative expenses, the balance of the proceeds of the settlement will be used to satisfy these claims on a pro rata basis. The agreement took effect on signature on May 11, 1979, and the first Chinese payment of $30 million was received on schedule on October 1, 1979. The funds were then distributed to U.S. claimants, and the assets were unblocked on January 31, 1980.

By Presidential directive, the freezing of Vietnamese and Cuban assets and controls over the remaining World War II assets of East Germany and Czechoslovakia should continue until American claims against these countries are settled. Claims are usually adjudicated and certified by the Foreign Claims Settlement Commission while blocked assets are administered by Treasury. The processes are in various stages of completion for these four claims programs. (See app. II.)

OBJECTIVES, SCOPE, AND METHODOLOGY

This report evaluates how the Treasury Department regulates and monitors foreign assets blocked pursuant to executive emergency authority. We initiated the review in the light of continuing congressional concern over the use of such authority to control international economic transactions and our perception of weaknesses in program administration plus improper blocking of Federal funds that had come to our attention during our previous audits. Principally, the review was conducted by examining the records and interviewing officials of Treasury's Office of Foreign Assets Control, Washington, D.C. Similar work was also performed at the:

--Departments of State, Defense, Agriculture, Justice, and other offices of the Treasury.

--Federal Reserve Board and other bank regulatory agencies.

--Foreign Claims Settlement Commission.

We also discussed the blocking controls with officials of major banks, securities firms, insurance companies, and State-abandoned property offices in California, Florida, and New York.

However, as a rule, we did not get access to their blocked account records to validate amounts previously reported to OFAC.

Most of our review was performed before the Iranian sanctions, which now constitute the bulk of OFAC's activity, were implemented. However, the report has been updated to include actions taken by Treasury at the President's direction concerning Iran.

CHAPTER 2

IMPROVED ASSET INFORMATION NEEDED

Treasury blocking controls have immobilized substantial assets belonging to certain foreign governments and nationals. However, Treasury has very limited information about what assets have been blocked. Without this knowledge, it cannot fully assess the program's effectiveness, give sound management advice regarding the assets' practical worth, or determine that the assets have been properly accounted for.

Knowing what assets have been blocked, in our opinion, is unquestionably a legitimate Government concern. When in September 1979, President Carter extended the blocking controls established under the Trading With the Enemy Act, he reaffirmed the U.S. aim to keep certain assets frozen pending changes in political relations with the affected countries. Although various foreign policy considerations apply, the primary ones have economic implications: i.e., they deny foreign exchange to hostile foreign governments and their nationals and retain a pool of blocked assets as a "bargaining chip" for negotiating the settlement of American claims with those foreign governments.

In this connection, it is essential to know the magnitude of the assets blocked, by country; their form and ownership; and whether any prior encumbrances against them could affect their value relative to the American interests. Without this knowledge, the United States has no real basis for determining how effective the blocking controls are in neutralizing U.S. investment losses abroad. Also, the value of blocked assets has been an important determinant in the size of claims settlements as well as the source of the compensation paid in these settlements.

The United States has an indirect responsibility for the safe custodianship and maintenance of value of blocked assets under the control of U.S. financial institutions. Because changes in ownership rights have occurred during the lengthy time that some assets have been blocked and political repression prevents certain owners from exercising their management prerogatives, we believe there are ample opportunities for the assets to become lost or their value to be depleted. Although the asset-holders are ultimately accountable to the owners for the assets' safekeeping, we believe that OFAC as the administering agency needs to have the means to be able to independently check and monitor the assets to assure that they are properly accounted for and kept from being wasted away.

We found that OFAC's inability or unwillingness to systematically inventory and monitor blocked assets has resulted in virtually complete dependence on asset-holders to care for the assets and comply with the regulations. Consequently, OFAC assumptions regarding the assets' worth and their use for settling American claims could contain significant inaccuracies.

OFAC's "EMERGENCY" RATIONALE

The emergency nature of the authorizing legislation underlies OFAC's very limited involvement in accounting for and managing blocked assets. Treasury officials told us that, in their view, the OFAC regulations were not intended to be used as a permanent peacetime control program but rather as a measure to combat temporary political and economic problems. In keeping with this understanding, OFAC interprets and disseminates national policy in the form of regulations to the financial community and the public, relying mainly on institutional transfer points, such as banks, for voluntary compliance. Because of the effects that sudden policy shifts and owner preferences can have on the status and value of blocked assets, OFAC management generally has regarded accountability and surveillance of the assets to be impractical, too costly, and unnecessary in any event.

Treasury officials told us that it is not necessary to know the current status and history of a particular blocked asset before reaching a decision to unblock it. Assets are not unblocked or licensed pursuant to an individual application unless there is a change in the owner's status or in the policy applicable to the entire class of assets. In neither situation, do Treasury officials consider the history of a particular asset ordinarily relevant.

We do not agree that asset accountability and monitoring is generally unnecessary. This is not a temporary program, as evidenced by the fact that some of the existing blockings commenced in the 1940s. The magnitude of the blocked assets and the host of problems that could arise over them strongly suggest the need for a Government information system to facilitate active monitoring and control and to improve policy decisionmaking.

DEFICIENT KNOWLEDGE OF ASSETS

Complete censuses of blocked assets are available only for China (1951, updated in 1970) and Cuba (1964). Blocked North Korean assets were found to be negligible. Telephone surveys of Vietnamese and Iranian assets held by major financial institutions were made following their freeze, evidently because OFAC officials felt the conditions warranted having a barometer of the magnitude of the value of assets. Subsequently, in April 1980, the President directed that a formal census be conducted of Iranian blocked assets. No other attempts have been made to keep asset inventories current or to use them in connection with establishing and maintaining a permanent record of all blocked assets for accounting and reconciliation purposes.

OFAC control records for blocked assets do not exist, except to the extent they support the specific censuses or surveys. Changes which occur affecting the status, location, and worth of the assets are not necessarily reported to OFAC. Systematic periodic reporting by holders is not required and OFAC does not itself track those assets identified by census as being blocked. Thus, OFAC's asset data is valid only at the time it is obtained and, since it is not verified, is only as good as the asset-holders' representations.

Inability to reconcile Chinese assets

Lack of comprehensive knowledge of the blocked assets and the effect that licensing transactions have had on them made it impossible for OFAC to reconcile significant reported differences in the China program, the only one for which census data was available with which to perform a full reconciliation. The 1970 census was able to account for only 86 percent, or $90.8 million, of the original $105.4 million, of blocked assets identified in the 1951 census. Another $4.7 million was subsequently identified. However, it appears that OFAC's inability to locate the bulk of the $14.5 million difference may have had a direct impact on American claimants since little, if any, of this amount was included in the $80.5 million the Chinese Government agreed to pay to settle these claims. The amount the PRC paid to secure the unblocking of Chinese assets corresponded exactly with OFAC's estimate of their value at the time the agreement was concluded.

In those instances where OFAC could not find in its files a license that authorized release of the funds, it sought an explanation for the release from the holder. If a satisfactory explanation was given, the release was considered to be licensed. In addition, Treasury has identified 270 cases involving $4.4 million in disputed funds where holders of assets under the 1951 census reported no asset under the 1970 census; Treasury had no record of authorizing their unblocking.

OFAC's estimates of asset values were determined as shown below.

	(millions)
Value of assets, 1951 census	$105.4
Less assets not identified, 1970 census	-14.6
Assets accounted for, 1970 census	$ 90.8
Less licensed and unauthorized blockings	-35.5
Add new blockings and appreciations	21.2
Value of assets, 1970 census	$ 76.5
Subsequent identifications and appreciation	4.0
Estimated value, 1979	$ 80.5

OFAC ASSET DATA NOT RELIABLE

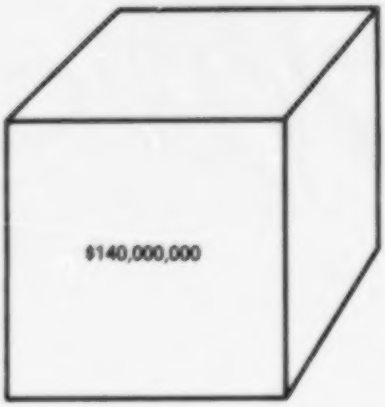
Information obtained during our review indicates that OFAC estimates of the value of blocked assets are not reliable. Although we did not try to confirm their value, we did make certain inquiries designed to test the validity of the OFAC estimates. We found that not only were the estimates significantly overstated in certain instances, and to an extent that they affected overall totals, but also the impression conveyed, that the value of blocked assets has a corresponding value for the purpose of settling claims or other use as an offset, is almost certainly very misleading.

Value of blocked Vietnamese assets overstated

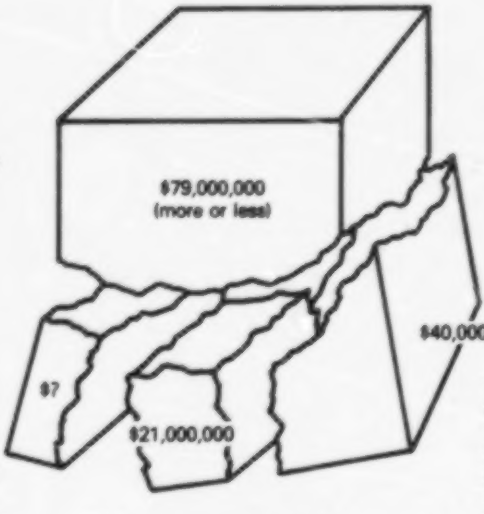
Treasury's estimate of the recoverable value of Vietnamese assets serves as an illustration. In July 1979 testimony on a bill to authorize the Foreign Claims Settlement Commission to receive and determine private claims against the Socialist Republic of Vietnam, Treasury's General Counsel told a House committee that an estimated $140 million in Vietnamese assets was blocked. The $110 million estimate given for private claims made it appear that the blocked assets were sufficient to cover these claims.

We believe the Treasury estimate seriously misrepresents the real potential of these assets to satisfy existing American claims. To begin with, we found that a major U.S. bank with the largest reported Vietnamese holdings in the 1976 survey could not immediately identify more than about $6 million of the approximately $40 million in blocked assets previously reported. We asked OFAC to check into the matter and, in doing so, it obtained the bank's explanation that the assets were valued at about $19 million and that an overstatement of $21 million had occurred through a double-counting error.

COMPOSITION OF VIETNAMESE ASSETS ESTIMATE



Treasury reported this amount as its current estimate of blocked Vietnamese assets to the House Foreign Affairs Committee in July 1979. It comprises $100 million of Vietnamese accounts of $50,000 or more tabulated in a 1975-76 telephone survey of major U.S. banks, plus $40 million of a third-country bank account having a Vietnamese interest.



The actual value and composition of these reported assets have never been verified.

Third-country bank account considered to have a Vietnamese interest. Funds were released in January 1979 pursuant to an agreement permitting Treasury recall of the $40 million, plus interest, subject to likely litigation.

Represents the unknown value of licensed transactions and unblockings. To what extent they are offset by accounts under $50,000 and other previously unidentified blockings is also not known.

GAO was instrumental in discovery and acknowledgement by a major U.S. bank, which in 1975 reported holding $40 million in blocked Vietnamese assets, that it double-counted and overstated its assets by $21,000,000.

Another $40 million represented to the Committee as being a blocked Vietnamese asset had been released from blocking subject to recall. At issue is whether a third-country bank acted illegally in assisting the Vietnamese to transfer U.S. currency to a domestic bank for dollar credits. After initially blocking $40 million of the third-country bank's assets in the United States, Treasury conditionally released them in January 1979, subject to the assets' recall upon demand and to a successful court verdict if the bank chooses to contest the matter. (See p. 29.)

The $140-million estimate of blocked Vietnamese assets does not consider a number of other factors, such as small accounts, subsequent blockings or unblockings, and changes in asset values, which could significantly alter Treasury's estimate. However, if the Chinese program--in which the 1970 census was $25 million below that of 1951--is indicative, the net effect of these factors may well be a decrease from Treasury's valuation.

The illustration on page 13 depicts how these factors affect the reliability of Treasury's estimate.

BASIS LACKING FOR EFFECTIVE PROGRAM CONTROL AND DECISIONMAKING

As is evident, OFAC's lack of a current asset information system causes it to depend on private financial institutions to block and maintain accountability of assets in conformity with the governing regulations. Consequently, OFAC has little, if any, basis on which to monitor and apply corrective action to suspected problems or irregularities nor to reconcile differences which may exist between its records and those of the asset-holders.

OFAC needs to administratively control blocked assets and monitor asset-holder practices and also to keep policymakers informed about program results and their relationship to objectives. Lacking reporting input, OFAC cannot and obviously does not provide substantive reporting on the effect and/or status of its blocking and licensing activities. The Secretary of the Treasury's annual administrative reports to the Congress on OFAC operations contain only workload data (i.e., number of license applications received and acted upon) which, absent other indicators, has little particular meaning; no information on the magnitude of the blocked assets or the value of licensing activity is provided. In addition, as previously discussed, blocked asset data conveyed by OFAC to the Congress and executive agencies in connection with claims adjudication legislation and settlement negotiations has been incomplete and possibly misleading.

Need for more complete information

OFAC needs a current and complete inventory and control records of blocked assets if it is to have effective oversight of these assets.

OFAC's establishment of an asset information system need not place an unwarranted reporting burden on asset-holders. For existing programs, the holders are already required to keep full and accurate records of transactions and to furnish such reports as Treasury may require, including specific notification of asset transfers to other holders. For new programs, we believe that OFAC should make the reporting of initial blockings mandatory. The identification of assets currently blocked could be carried out on a staggered basis as circumstances and resources permit. However, once the assets are identified, holders should be asked to update changes in asset description, value, custodianship, etc., through recurring status or activity reports. Notifications of asset transfers and of any significant occurrences affecting the physical and financial protection of assets should be reported to OFAC semi-monthly or monthly; more ordinary changes and updates could be reported at less frequent intervals, as volume and activity patterns dictate.

Prior to its blocking of the Iranian assets, OFAC estimated it would cost $190,000 to conduct a census of the then-blocked assets and take 2 years to complete, requiring 9 staff-years initially but declining to 6 during the second year. OFAC believes that such an expenditure is ordinarily not justified for data which inevitably would lose its usefulness as time passed. However, the decision to conduct a census may be made when it is seen as serving a foreign policy objective--as evidenced by the President's decision in April 1980 to survey the blocked Iranian assets. (See app. I.)

We agree that taking a census of blocked assets without making adequate provisions for keeping the data current is of limited usefulness. As a matter of fact, one of the major problems is that OFAC does not currently have a way of determining what changes occur in the assets and their value. The lack of such knowledge apparently caused OFAC to anticipate that resolving problems relating to the unauthorized release of property would take most of the staff time during the second year of the census-taking.

Since the asset-holders would perform the inventory and report to OFAC, we fail to understand why the census would be so burdensome on OFAC if it first designed a reporting system to facilitate incorporation of both the initial census and the periodic updating into a master record file. To avoid peak workloads at OFAC, the incorporation of the incoming data could be done in phases until the file was complete and then currently thereafter. Subsequently, the elimination of controls over low-value assets would alleviate the volume of information in the long run.

In commenting on proposed Treasury reporting requirements for blocked assets, holders expressed the view that it would be helpful if they knew more precisely what information would be requested, if recurring or piecemeal surveys could be avoided, if low-value assets could be eliminated from the controls, and if the requirements were kept simple so as not to create an undue administrative burden on them.

Need for improved recordkeeping

We found that OFAC's manual index and files system was incomplete, poorly organized and maintained, and lacked the necessary substantive asset data with which to form sound rational judgments as to how effectively the blocking program is being carried out. Recordkeeping is done by general subject matter, and such functions as licensing and enforcement are controlled by an elaborate system of cross-indexes arranged according to the set of regulations involved, the country, the type of goods or transactions, and the beneficiaries, without regard to the specific asset affected by the blocking. This not only makes finding basic data difficult but also makes retrieval and tracking of related asset data virtually impossible.

Effective use is not made of the asset data obtained from holders or from licensing transactions. While the holders' reports of asset transfers have obvious value for recordkeeping and monitoring purposes, OFAC's Director told us the reports were not needed or used to maintain accountability; rather, they were insisted on more as an exercise to impress upon holders the seriousness with which they should regard OFAC's blocking and recordkeeping requirements. Licensing decisions are made and recorded independently of other existing asset data.

We believe OFAC's system of keeping records ought to permit a ready reference to all the significant details regarding an asset at a glance. From asset-holder reports and improved correlation of licensing and asset data, OFAC should be able to compile reasonably current master records of all blocked assets as a basis for assigning control numbers to correspondence concerning them. By filing or cross-indexing the records in this manner, OFAC would have a solid basis for monitoring compliance with its regulations and for maintaining asset control. Also, it could provide a much needed tool for program evaluation and management effectiveness.

CONCLUSIONS

We believe it is essential to know the magnitude of assets blocked, by country; their form of ownership; and whether any prior encumbrances against them could affect their value relative to American interests. We found that OFAC's inability or unwillingness to systematically inventory and monitor blocked assets has resulted in virtually complete dependence on asset holders to care for the assets and comply with the regulations.

RECOMMENDATIONS

We recommend that the Secretary of the Treasury minimize the asset information gap by requiring the Director of OFAC to:

--Make a comprehensive census of the assets currently blocked pursuant to OFAC regulations.

--Follow through on Treasury's prerogative to require asset-holders to periodically report new blockings, dispositions, and status of assets in custody.

--Establish and maintain master control records for blocked assets, based on acquired census data, periodic asset-holder reports, licensing activity, and other sources.

AGENCY COMMENTS AND OUR EVALUATION

Treasury told us that they agreed with recommendations in principle, but that the draft report did not reflect its renewed commitment to data-collection activity. Specifically, our draft did not address the census of Iranian assets and claims undertaken by Treasury early in 1980. Also, a proposed survey of all property subject to new interest regulations, though deferred on account of the Iranian blocking, was cited as action it had commenced prior to our review to supplement earlier asset censuses and to improve the data base for blocked property. Treasury did agree to consider including a requirement in the regulations for holders to report periodically on changes in the status of previously reported assets, once a census was completed.

The report has been updated and revised to reflect Treasury's actions following the blocking of Iran. Although the deferred survey of non-Iranian assets would be applicable only to assets held in non-interest-earning accounts, we feel it represents movement in the right direction.

CHAPTER 3

NEED FOR INCREASED PROGRAM MONITORING

OFAC relies predominantly on private financial institutions to identify and restrict the use of accounts belonging to designated foreign governments and nationals, and to provide protective custody of the assets. Whether and to what extent the institutions are complying with OFAC's blocking and custodial requirements are not known. OFAC does not systematically monitor their activities, nor can it do so effectively until it has an information system enabling it to make asset reconciliations and program evaluations.

OFAC's reliance on private asset-holders is consistent with the Government's desire for a tough economic defense measure to help protect American investment abroad while avoiding the appearance of a hostile asset seizure. Although this keeps the Government from becoming embroiled in asset custody and management, it does not follow that the asset-holders should be exempt from accountability for the assets. To the contrary, we believe that the nature of the program is such that OFAC not only has a duty to see that the controls are effective but also to ensure that the various interests of the owners and claimants are protected.

OFAC's operating philosophy of not regularly monitoring how assets are blocked, controlled, and managed by asset-holders gives no assurance that the program's objectives are being achieved to a maximum extent consistent with fairness and practicality. In fact, the asset-holders did not appear to have any particular incentive to become well informed about or to more closely adhere to the existing regulations. Also, we found that certain provisions had not been implemented because they had not been adequately publicized.

ASSET-HOLDER BLOCKING AND CUSTODIAL FUNCTIONS NOT MONITORED

How the asset-holders perceive and react to the OFAC blocking regulations obviously has a direct bearing on what assets are blocked and how they are maintained. We found that some asset-holders did not appear to have a clear idea what was expected of them; consequently, they did not always heed regulation requirements. Furthermore, they had little incentive to do so since OFAC did not systematically review their blocking or recordkeeping. Blocked assets require special protective handling and are more likely to cause controversy or litigation than other accounts; and, in the absence of civil penalties for violations of the Trading with the Enemy Act (though provided for in the 1977 International Emergency Economic Powers Act) and OFAC asset data with which to prove criminal negligence, punitive action against holders has been rare. With no active OFAC monitoring or systematic feedback from the holders, some assets may have inadvertently escaped the controls or, if blocked, accountability for them may no longer be able to be established.

Asset identification

Neither OFAC nor anyone having reviewed its operations has determined whether the financial institutions responsible for the asset blockings are aware of, understand, and have committed themselves to carrying out this task. Therefore, it is possible that significant amounts of assets may have escaped blocking controls and that such nonapplication or evasion of the controls could go undetected. Moreover, there is no assurance that the desired program objectives are being achieved to the maximum extent.

We found indications that indentification of assets for blocking might not be as comprehensive as it could or should be. Bank officials told us they rely mainly on information supplied by the depositor, i.e., nationality, residency, etc., when determining whether or not to block specific amounts. The information provided by the client or an agent may not always make the prohibited foreign national interest readily apparent. A number of major banks and brokerage firms that we visited and that we expected to have some blocked assets, acknowledged having none. Finally, implementing instructions sent by the banks to their branches tended to be much simpler and less comprehensive than the OFAC regulations; e.g, they omitted prohibitions on access to safe deposit boxes, use of drafts, and release of securities.

Custodianship practices and fund transfers

OFAC does not determine what happens to an asset once it becomes blocked. Presumably, it remains blocked, since unblockings require Treasury approval through issuance of a license. However, the asset may not retain the same form or value or be in the same location. The OFAC regulations permit owners to invest their assets in whatever way they choose, subject to only minimal restrictions, and holders are specifically authorized to transfer accounts to other holders on the instructions of owners or trustees and to debit accounts for customary service fees.

Why asset transfers need to be monitored

With owners essentially free to invest their assets as they see fit and with State agencies increasing vying for possession of dormant assets, blocked assets could inadvertently become unblocked as they are switched from one type of account or institution to another. In addition, asset movements and the passage of time make it harder to keep track of the assets.

OFAC regulations attempt to guard against these dangers by stipulating that (1) any transaction in violation of the regulations is rendered null and void (restoration of debited accounts have been few); and (2) a bank transferring a blocked account to another holder must report to OFAC the name and address of the account owner along with a confirmation from the transferee that the account remains blocked. However, transferors need not obtain prior OFAC permission to effect a transfer. OFAC does not determine whether banks are reporting this information and even when they do, does not use the information to keep track of the assets. If it did so, we believe it should have been able to account for the missing Chinese assets which became "lost".

In addition to maintaining asset control, it would be useful for OFAC to have information on asset movements and changes in valuations as clues to whether policies are effective and whether asset-holders are complying with the regulations. For example, if the asset transfers are executed without the requisite protective handling and notification or they place an unwarranted administrative burden on the holders, OFAC may wish to amend its transfer provisions.

The notification requirement for transfers was not included in the Cuban assets and foreign funds control regulations and is acknowledged by an OFAC official to have caused problems. Because of the many years that the blocking of these assets have been in effect, we believe OFAC may have serious difficulty when it tries to locate the assets.

Why asset-holder fee assessments need to be monitored

Banking institutions have been and continue to be permitted to debit blocked accounts for normal service charges. Simultaneously, they have not been required to pay interest on amounts which were blocked and remained in demand deposit accounts--at least until April 1979 when revised OFAC regulations made payment of interest on these accounts mandatory. Depletion of the assets in this manner has caused public concern that some assets have been phased out of existence. The requirement to place blocked demand deposits into interest-bearing accounts should help counter the depletion of assets, but bank service charges and cancellation of interest accruals could make the benefits more illusory than real.

A consultant on unclaimed property, representing several States, commented in late 1978 in OFAC's proposed interest regulation that audit results have confirmed a banking industry practice of ceasing interest payments on accounts having no additions or withdrawals over a relatively short time span; however, sevice charges were imposed in almost every instance. This practice resulted in banks taking over low-value accounts.

Also, California banks' practice of deducting service charges and accrued interest from accounts being turned over to the State abandoned property office, though no such charges were made to depositors, was termed inconceivable in a 1976 court decision which opposed it. The decision reportedly involved many million of dollars and one bank, contending that reasonable service charges were lawful, was still contesting the issue in 1980.

Quite simply, we believe OFAC has a responsibility to protect blocked account values. To the extent that monitoring holder custodial practices aids in this pursuit, their practices should be monitored.

Recordkeeping

OFAC does not determine whether asset-holders are complying with its recordkeeping provisions which require holders to maintain complete and accurate records to enable them to respond to OFAC reporting needs and inquiries. The absence of periodic reporting and the infrequency with which OFAC has requested asset data provide no incentive for holders to separately account for blocked assets; our review at the banks indicated that the assets generally cannot be readily identified. A number of the banks and other asset-holders we contacted could not provide us with statistical data on blocked assets in their custody or were reluctant to do so. When they did give us asset data, it sometimes contrasted sharply with OFAC's data.

Also, the consultant representing several States on unclaimed property persuasively argued against an OFAC proposal which could terminate the licensing of asset transfers by institutional holders to State abandoned property offices because of the inability of the State agencies to respond to inquiries regarding assets in their possession. He argued that the holders themselves had not kept the required records. Specifically, he charged that:

> "Audit after audit has confirmed that the holders have not even maintained such records. By reason of mergers of financial institutions, conversions to data processing systems from manual systems and for other reasons there is a well documented history of records of inactive accounts simply disappearing."

Compliance checks

Treasury efforts to determine asset-holder compliance with the blocking regulations have been minimal. Management studies of OFAC's operations have not addressed this issue. The basis for all the regulations except the Iranian assets control regulations is the Trading With the Enemy Act, which is a felony statute only and does not provide for civil penalties for violations of a nonwillful nature. Most violations are of this type. As a practical matter, willful violations have been discovered very infrequently, possibly due, in part, to OFAC's lack of asset data for facilitating investigations. Full field investigations of violations have been rare, apparently reflecting management's belief that efforts should be concentrated on major cases and that closer program surveillance involving lesser violations would not achieve sufficient benefits to outweigh the staff and travel costs involved. Nor has OFAC obtained the assistance of bank and other financial institutions' regulatory bodies to check--in connection with their regular inspections--whether the prescribed blocking procedures are being followed.

For better leverage in dealing with nonwillful violations on future blockings, Treasury suggested to the Congress that civil penalties be provided and such a provision was adopted in the 1977 International Emergency Economic Powers Act. We believe that, at an acceptable cost, OFAC can (1) obtain a much better perspective of holders' compliance, (2) learn whether its program aims are being achieved by making better use of the information available from holders and spot-checking it, and obtain the cooperation of Federal and State regulatory agencies to monitor procedures and asset data.

Recommendations, agency comments, and our evaluation

We recommend that the Secretary of the Treasury:

- --Use asset status reports and activity data to identify potential problem areas requiring followup.
- --Request the cooperation of Federal and State regulatory agencies to test asset-holder procedures or to verify asset data as necessary to ensure that blocking goals are being met and that asset knowledge is valid.

Treasury did not dispute the essential point of the need to control blocked assets administratively and monitor asset-holder practices but said it involved questions of resource availability. It acknowledged that OFAC for the most part had not vigorously monitored compliance with holder reporting requirements. However, it disclaimed knowledge of any cases where this had resulted in the loss of assets. Similarly, it considered as a valid criticism that the notification requirement for reports of transfers was not included in two of its regulations. A review was planned to find out whether the omissions caused any loss of blocked assets.

We believe more effective asset monitoring need not place an undue burden on Treasury. It met the resource needs brought on by the Iranian crisis through reallocation of staff and acknowledges it can probably continue to draw on the experience and resources developed in conducting the Iran census.

NOTICES NOT ADEQUATELY COMMUNICATED TO HOLDERS

The adequacy with which asset-holders are notified of the regulation provisions and any changes thereto bears directly on the success of OFAC's blocking programs and emphasizes the need for regular monitoring. Because of the vast number of domestic and foreign banks and other financial institutions affected by the regulations, such as savings and loan associations, securities firms, insurance companies, etc., OFAC cannot possibly directly notify them all. OFAC has an extensive mailing list of U.S. businesses for distributing regulatory material, but it also uses Federal Reserve district bank channels, Federal Register announcements, and press releases to the major newspapers and wire services to publicize the regulations. However, since OFAC neither requests nor obtains any systematic feedback from asset-holders, it has no assurance that the notifications are received.

We found indications that lack of notification might be a serious problem. In a number of major financial institutions that we visited, the officials were only vaguely familiar with the regulations. Only about half of the asset-holders we surveyed in June 1979 acknowledged having received or being familiar with a regulation amendment published in March 1979 requiring banks to pay interest on non-earning demand deposits. Some holders had not received or acted on the regulations following their issuance, while others merely took precautionary actions until they received written instructions.

Part of the problem, we were told, is that mail or telegraph notifications are not directed to the specific persons or departments in the organizations responsible for account operations, so often get delayed or lost. Since the functions differ by organization and the responsibilities are shifted within an organization from time to time, this problem can perhaps be reduced but not eliminated altogether--hence the need for systematic feedback and/or monitoring.

Not all organizations assisting OFAC in program literature distribution were certain of their roles. For example, an official with the Federal Reserve Bank of San Francisco, which has been assisting with the blocking program since the early 1950s, informed OFAC in December 1978 that the staff could not locate instructions on the bank's responsibilities and did not know what to do with copies of amendments received in the mail with no cover letter or other instructions as to their disposition. Furthermore, he said they considered the distribution of OFAC documents discretionary and indicated that at times they had not made distribution because of problems in tardiness and paper reproduction.

Another potentially important aspect of the problem is whether third-country banks are properly notified of and understand the regulations. OFAC construes its regulations, except those applicable to Iran, as applying to dollar assets wherever they may be held, to prevent circumvention of U.S. blocking controls by the designated countries and their nationals. This OFAC interpretation is being challenged and notification has already been an issue in such blockings. A third-country bank, which had its assets of $40 million blocked because it assisted the Vietnamese to transfer dollar currency to the United States, claimed it did not know about the OFAC regulations.

Accordingly, we believe that some sort of regular followup or test survey of asset-holders would assist in determining whether regulation changes were received and understood, whether the controls are being observed, and where the "soft spots" are. However, the feedback should not take the place of, or interfere with efforts to inventory and obtain, status reports on all blocked assets but should focus on how well blocking and custodial functions are being carried out.

In this connection, Treasury had commenced action prior to our audit to supplement its asset data base acquired from earlier censuses. Substantial time had been devoted to completing a new form (TFR-611) and instructions for a survey of all property subject to the interest regulation, announced in March 1979. The regulation directed asset-holders to promptly report all assets affected by the change on this form which was to accompany the regulation. However, Treasury deferred requiring the report because the Iranian blocking required both OFAC and the involved private institutions (which are similar for all programs) to give priority to the reporting requirement under that freeze. We are told that once the census of the Iranian claims and assets is complete, this form and the accompanying reporting requirements will be promulgated.

Recommendation and agency comments

We recommend that the Secretary of the Treasury supplement OFAC monitoring efforts by obtaining random and timely feedback from asset-holders when new regulations are issued to find out if they are understood and correctly implemented.

Treasury did not comment specifically on this recommendation. However, as previously mentioned, it acknowledges the general need for increased asset monitoring.

CHAPTER 4

PROBLEMS AND ISSUES RAISED BY THE BLOCKING CONTROLS

The application of the blocking controls has produced some situations which appear to challenge their basic fairness and effectiveness. These situations include whether and to what extent third-country financial institutions should be bound; whether low-value assets should be blocked; what responsibility OFAC and the holders have with respect to income accrued to the holders on blocked non-interest-bearing accounts; and whether blocked assets should be transferred to the custody of the States as unclaimed or abandoned property.

CONTROVERSIAL APPLICATION OF CONTROLS TO THIRD COUNTRIES

To ensure comprehensive and consistent administration of the blocking controls, OFAC has construed its regulations to have very broad application. This broad application, which is unique among the major Western nations, has sparked considerable controversy and litigation which will probably take years to untangle. Partly because of these problems, the Iranian regulations were modified with respect to their extraterritorial effect.

Although there are various distinctions in the treatment of third-country problems in each set of OFAC's regulations, a major one relates to the handling of dollar assets in foreign banks outside the United States. Up to the time it issued the Iranian regulations in 1979, OFAC applied its regulations not only to domestic accounts of U.S. and foreign banks but equally to dollar assets abroad, regardless of location. Its rationale is that if it did not regulate dollar assets in third-country financial institutions, designated nationals could easily avoid U.S. controls by directing their transactions through such intermediaries.

For example, except for Iran, dollar assets known to have been obtained by a third-country bank from a blocked country are subject to OFAC control via a "cover account" mechanism if they were used to transact business with a U.S. national. According to this theory, when a foreign bank accepts a dollar deposit, it hedges (or "covers") its dollar liability to its depositor by maintaining a dollar account in its name with a correspondent bank in the United States. OFAC policy is that this represents an "interest" of the foreign depositor in an account held within the United States. If the foreign depositor is a national of a designated country, the amount of that "interest" in the dollar cover account in the United States is blocked. Whether such blockings would be upheld in a court challenge is at least debatable and might depend on what country has jurisdiction of the case. In any event, the precise magnitude of U.S. blocking of third-country bank and commercial firm assets having an identified designated national interest is not known but believed to be substantial.

OFAC's decision to not apply the "cover account" mechanism to the Iranian blockings has not eliminated the also controversial blocking of assets in foreign branches of U.S. banks. Bankers and lawyers have raised many questions about its legality and the issue is being litigated not only in the United States but in Europe, with billions of dollars at stake.

Still another problem can (and does) arise in cases where a foreign government will seek to exert influence on behalf of its national, say a foreign bank, on a question which is essentially one of U.S. law and jurisdiction exclusively. The political dilemma posed by such a situation is well illustrated by the contested blocking of a third-country bank's assets in the United States for its participation in an unauthorized currency transfer from Vietnam.

Third-country bank assets blocked

The U.S. assets, valued at $40 million, of a third-country bank were blocked when OFAC determined that the bank had acted on behalf of the Vietnamese in converting its nontransferable U.S. currency into dollar credits through routine shipments of the currency to its correspondent U.S. banks. During an 18-month period in 1975 and 1976, the third-country bank shipped a series of cash packages to U.S. banks totaling $40 million. Although OFAC was aware of the origin of the funds by early 1978, it did not block the bank's U.S. accounts until August 1978. We were told that investigatory and legal work necessitated the delay in the blocking. To facilitate administration of the funds, the blocking was centralized in one account. Also, the blocking was not applied to the foreign bank's own deposits but toward an interest-bearing credit that a U.S. bank extended to the foreign bank.

In the ensuing discussions with Treasury officials, the foreign bank's lawyers claimed that the bank had misunderstood or lacked knowledge of the OFAC regulations and that it had shown no intention of committing a wrongful act but had acted in accord with its own national banking laws, which prohibited the bank from giving OFAC depositor or account information. The lawyers backed up these claims with a government inspection board report which certified there was no Vietnamese interest in the assets at the time they were blocked on August 30, 1978, and that there was no intent on the bank's part to violate U.S. law. The lawyers did not contest the essential OFAC allegation that in 1975 and 1976 the bank brought U.S. currency into this country in which there existed a Vietnamese interest. However, they said that public disclosure of the blocking in the bank's host country, which would be triggered when the bank had to file its annual report with the government in February 1979, would have serious political consequences which could strain relations between the United States and the bank's host country.

Treasury's position was that the foreign bank had violated U.S. law. Treasury regarded any currency with a Vietnamese interest as automatically blocked as soon as it entered the United States, unable to be moved legally without a license issued by OFAC. Therefore, at the time of the blocking, it was immaterial whether or not any Vietnamese interest existed in those particular funds.

However, at least partly in response to the threat of an adverse public reaction resulting from disclosure of the blocking, Treasury agreed to release the $40 million in January 1979 under an agreement whereby the funds could be recalled under specified conditions. The agreement, which allegedly does not significantly alter U.S. rights, halts at about $2 million the interest due to the U.S. bank on the blocked credit until the issue is resolved. Briefly, the foreign bank agreed to the recall of the $40 million, plus interest, upon OFAC's request for the funds but reserved the right to challenge it in a U.S. court. In the meantime, the bank has the use of what supposedly are blocked funds until a final adverse judgment has been declared.

We believe the case raises some disturbing issues. Obviously, the most immediate and critical issue is whether the blocking can be sustained, because failure to do so could cripple OFAC's efforts to regulate prohibited financial transactions routed through third countries. In any case, the treatment accorded the foreign bank in unblocking its assets may set an undesirable precedent, and it provides a possible remedy for other owners to secure unblocking of their assets under similar arrangements. The Vietnamese have not been denied use of the dollar funds and, even if the U.S. court should uphold the blocking, the assets probably would not be preserved for future settlement of American claims. The taking of these assets to satisfy U.S. claims against Vietnam would be subject to approval by the Congress, and it is uncertain whether this approval would be granted. Alternatively, the assets would likely be of little or no value to the United States in negotiating a claims settlement directly with the Vietnamese since the latter has no stake in them.

In the light of the significant difference which appears to exist between the stated value of third-country blocked assets and their actual worth in an eventual claims settlement, it becomes even more obligatory for OFAC to know what assets are blocked and to estimate their realizable value. Furthermore, when administration officials put a value on blocked assets in congressional testimony, as they did in support of a proposed Vietnam claims program in July 1979, we believe they should make full disclosure of all significant facts and contingencies affecting their realizable value to avoid any possible misunderstandings.

DISCRETIONARY USE OF BLOCKING CONTROLS

Whereas the OFAC blocking regulations are generally designated to restrict certain countries' dollar assets and earnings, strong domestic and foreign policy interests can have the effect of overriding the restrictions and permit transaction which appear to run counter to the primary blocking objectives. A number of these authorizations are expressly covered in the regulations and are available for public consideration and guidance. For example, Chinese accounts opened since 1971 have not been subject to the blocking controls because of an attempt to foster trade between the United States and the PRC, and U.S. foreign subsidiary trade with Cuba has been permitted since 1975. Payments may be made for expenses incurred in connection with tourist travel to the embargoed countries since the Carter administration eased travel restrictions in 1977, and personal remittances have been allowed since 1978 for specified amounts to close relatives living in or emigrating from Cuba and Vietnam. In addition, the U.S. Navy has spent millions of dollars for Cuban salaries and services at its Guantanamo base.

The Director of OFAC may make other authorizations not specifically covered by the regulations on a case by case basis. Because the underlying emergency legislation conveys virtually unlimited possibilities for regulating economic transactions, particularly international transactions, an official in charge of Justice's Office of Foreign Litigations contends that the Director of OFAC "wields extremely broad power".

In exercising this power, the Director has traditionally taken a hard line with respect to the unblocking of assets, ostensibly to preserve them for possible use in a claims settlement. For example, American creditors are not permitted to collect judgments against blocked debtors' assets, American heirs are not allowed to inherit blocked assets, and refugee owners of blocked corporations are not allowed to use the blocked assets.

In a well-publicized case, a Vietnamese bank official residing in the United States was paid nearly $50,000 by the Navy for contract work performed in pre-takeover South Vietnam in which he had a proprietary interest. There was no consideration as to whether the funds involved should have been blocked. The ex-Saigon banker also sought $221,000 for similar contract work performed for the Army. The Army refused to make payment on the grounds that the money owed was blocked, and it was supported in this determination by OFAC and upheld by an April 1979 California court ruling. Subsequently, OFAC which spotted the Navy $50,000 payment in a related license application, attempted to reverse it by threatening to prosecute the banker for violating the Trading With the Enemy Act if he did not make full restitution of the previously paid funds. The banker has appealed the court ruling and the case was still in litigation at the time of our review.

Also, a Treasury Fiscal Service official told us that a substantial but undetermined amount of funds remains deposited in a Withheld Foreign Checks Fund since the 1940s even though restrictions against some countries no longer apply. However, because of recording and filing difficulties, locating the funds would be a very time-consuming and costly job. Nevertheless, we were able to find that blocked Cuban assets included $6.1 million of withheld Treasury checks owed principally by the Civil Service Commission, Social Service Administration and Veterans Administration.

The gradual relaxation of controls and licensing discretion available to the Director of OFAC appear to have produced mixed results. They increase the flexibility with which the President and his delegated administrators can deal with unusual or special circumstances, but they also tend to obscure the purposes of the blockings and diminish the leverage used to satisfy American claimants.

BLOCKING OF SMALL ASSETS POSSIBLY COUNTERPRODUCTIVE

OFAC regulations require the blocking of designated foreign nationals' assets without regard to value. The fairness of this approach obviously cannot be faulted, but we do question the effectiveness of blocking low-value accounts, especially in the light of other actions taken to relax the controls. It is not known whether such assets would have a material effect on denying a country needed foreign exchange or diminising the proceeds that an American claimants can expect to receive in a settlement. However, we believe such a possibility is slight because of the insignificant value of the assets themselves and because of their increased vulnerability to account service charges. The earnings on larger accounts make them less susceptible to service charges. Finally, the administrative cost associated with identifying, blocking, and maintaining control of these assets could easily prove to be more than they are worth.

In any case, OFAC presently cannot make an informed judgment as to the merits of blocking small-value accounts since it does not know their number, their significance in relation to aggregate values, and the effect of their increased susceptibility to account service charges. However, it would be able to do so if all the assets were identified and asset-holders were systematically monitored.

Recommentation, agency comments, and our evaluation

We recommend that the Secretary of the Treasury use the data to be obtained on assets and asset-holder practices to determine at what value blocking of assets may be counterproductive and to establish a minimum amount at which assets should be blocked.

Treasury did not take a position on the substance of the recommendation. Rather, it said the discussion was not supported by analysis and did not consider subsidiary issues such as the possibility of evasions or other blocking goals. These goals might include consistency of foreign policy attitudes toward a blocked country or complete isolation of it.

Unavailability of current asset data prevented us from making such an analysis. Evasions should not take place if proper safeguards are present, and if blocking of low-value assets is regarded as necessary for foriegn reasons it should be recognized what the implications are in terms of costs and benefits.

BELATED CONCERN FOR PROTECTING ASSET VALUES

Until recently, OFAC has historically maintained a "hands-off" approach to the management of blocked assets aimed at preserving or increasing their real values, ostensibly because of a national policy which discourages interference with foreign private investment in the United States. This stance with respect to blocked assets has substantially benefited holders at the expense of the owners and/or Americans claimants. It was not until early 1979--some 28 years after the Chinese blocking took effect--that OFAC revised its regulations to require that bank deposits not held in interest-bearing accounts be transferred to accounts earning interest at a rate at least equivalent to the maximum paid on the shortest time deposit. The justification given for the change in the regulations was that required payments of interest on deposits was only equitable and the increased value of the assets would help to facilitate eventual claims settlements with China and other countries. The interest requirement was subsequently extended to Iranian assets.

Because many of the asset owners were unable or unwilling to assume responsibility for how their assets were invested for fear of adverse action against them, a large portion of the assets were left for years in non-interest-earning accounts, giving U.S. banks a windfall from these holdings. Banks have not been required to pay any interest on the assets they held and were able to enhance their liquidity position by virtue of being able to use the sums on deposit to offset a portion of their Federal Reserve demand deposit requirements.

The value of these benefits to the banks has been substantial. For example, roughly 90 percent of the more than $53 million in blocked Chinese assets identified as bank deposits in the 1970 census were held in non-interest-bearing demand accounts. This amount would have yielded more than $200 million had the assets been placed into compound interest-earning accounts when they were blocked, a sum which would have been more than sufficient to pay off American claimants for the full principal value of their claims.

As it was, the revision of OFAC's regulations to require payment of interest on all deposit accounts had little or no effect on the U.S.-China claims/assets agreement concluded in May 1979--only a month after the regulations took effect. Although Treasury officials considered requiring banks to pay interest on demand accounts retroactively, they eventually opted against imposing such a requirement.

Why Treasury waited so long to apply the interest provision is not clear to us. One OFAC official cited the idea of disturbing the owner's control over his property as little as possible and unspecified "foreign policy considerations" as the major reasons. While OFAC professes to shun management responsibility for the assets beyond setting certain general limitations aimed at avoiding loss of jurisdiction, some regulation provisions do appear to be designed to prevent the wasting away of asset values. For example, an owner desiring to use the funds in his blocked account to purchase securities would be confined to purchasing corporate issue listed on a national securities exchange and bonds at prevailing market conditions. Similarly, a blocked business is permitted to operate only so long as it does not engage in any transaction which directly or indirectly "diminishes or imperils" its assets or which prejudices its financial position.

We believe that maintenance or enhancement of the "real" value of assets is a legitimate OFAC concern and one that could have a direct bearing on American claimants. Accordingly, the provision to pay interest appears to have been long overdue. In addition, inasmuch as there may be other large blocked assets which have remained in non-interest-earning accounts for extended periods of time (i.e., the Cuban and Vietnamese assets), we suggested in our draft report that the Secretary of the Treasury negotiate with the asset-holders for crediting of retroactive interest. However, after considering Treasury's and Justice's comments setting forth the complexities and legal implications in taking such a step, we have withdrawn the suggestion.

ASSET TRANSFERS TO STATE AGENCIES SHOULD BE DISCONTINUED

Significant amounts of blocked assets have been transferred to and used by State abandoned property offices. A number of States have passed laws giving them the authority to seize dormant assets. In New York and California, for example, where the Nation's largest financial centers are situated, the laws require that bank accounts that have remained dormant 5 and 7 years, respectively, be seized. OFAC granted four States licenses to receive blocked property pursuant to these laws. It was expected that the States would establish adequate records to identify the assets and agree to hold the assets merely in custody until disposition was determined.

These expectations were not met. In late 1978, OFAC found that the blocked assets in State possession were not separately indexed and could not be readily identified.

Also, several State agencies acknowledged receiving blocked assets even though they had not been licensed to do so. Although information was generally unavailable on the value of blocked abandoned property held by State agencies, nearly $5 million was reported held by a half dozen agencies.

Subsequently, OFAC suspended and considered revoking the four licenses in the belief it might be able to maintain more effective control of the assets if they remained in the custody of banks and brokers than if they were transferred to these agencies. OFAC solicited the comments of State agencies and was persuaded against revocation. Instead, it decided in early 1979 to continue the licensing policy upon receipt of satisfactory evidence demonstrating the State agencies' capacity and willingness to comply with existing recordkeeping and custodial requirements. Pending receipt of this evidence, the suspended licenses had not been reinstated at the time of our review.

We believe that the transfer of blocked assets to State administrations interferes with OFAC's ability to regulate blocked assets effectively. The fact that OFAC identified five States taking property into custody without a license compared with four States it licensed nationwide certainly is not a good commentary on the States' awareness of the applicability of OFAC's regulations. The assets would not normally accrue to the States, except through loss of identity, and the requirement to hold assets in interest-bearing accounts will severely restrict any earnings potential for the State offices.

Maintaining the identity of the assets may be a major problem. Neither the owner nor OFAC necessarily knows when a State takes possession of an asset. The banks and State agencies must make a reasonable effort to notify depositors of an impending asset transfer, but the requirement for such notification has not always been heeded because of the possible detrimental effect to the owners. Because OFAC has not kept track of assets already transferred to State agencies, it may not recover some of them unless time-consuming checks of millions of State account records are made.

Moreover, the assets are not truly "abandoned" since asset dormancy is induced by Federal law. This appeared to be recognized by California's Controller, who stated in August 1978 that "Blocked Accounts should not be turned over to the State by any holder at any time unless the true owners of those accounts are not able to be located." Nonetheless, California and other State agencies are aggressively pursuing the identification and acquisition of dormant accounts, including foreign blocked assets, as they become subject to State possession laws. The banks in turn, faced with the prospect of having to turn the blocked assets over to State agencies, have been discovered avoiding crediting accounts with accrued interest and imposing service charges which reduce or deplete the principal just prior to making the transfer. It seems to us that banks and other holders would be more circumspect in their asset management if they remained directly accountable to OFAC.

In these circumstances, it seems unwise to provide a means for continuing such licensing. It would allow additional property to go to State abandoned property bureaucracies which operate under different laws and proedures and are accountable to administrations with varying resources, efficiency, and sensitivity to Federal Government concerns.

Recommendations and agency comments

We recommend that the Secretary of the Treasury:

--Revoke the licenses which permit the transfer of blocked assets to State administrations and amend the appropriate regulations to reflect this prohibition.

--Require State offices which already hold or receive blocked foreign assets to report them and to certify that the various asset custodial requirements are being adhered to.

Treasury said that it was willing to review its policy and had already commenced doing so.

CHAPTER 5

OFAC ASSET ADMINISTRATION

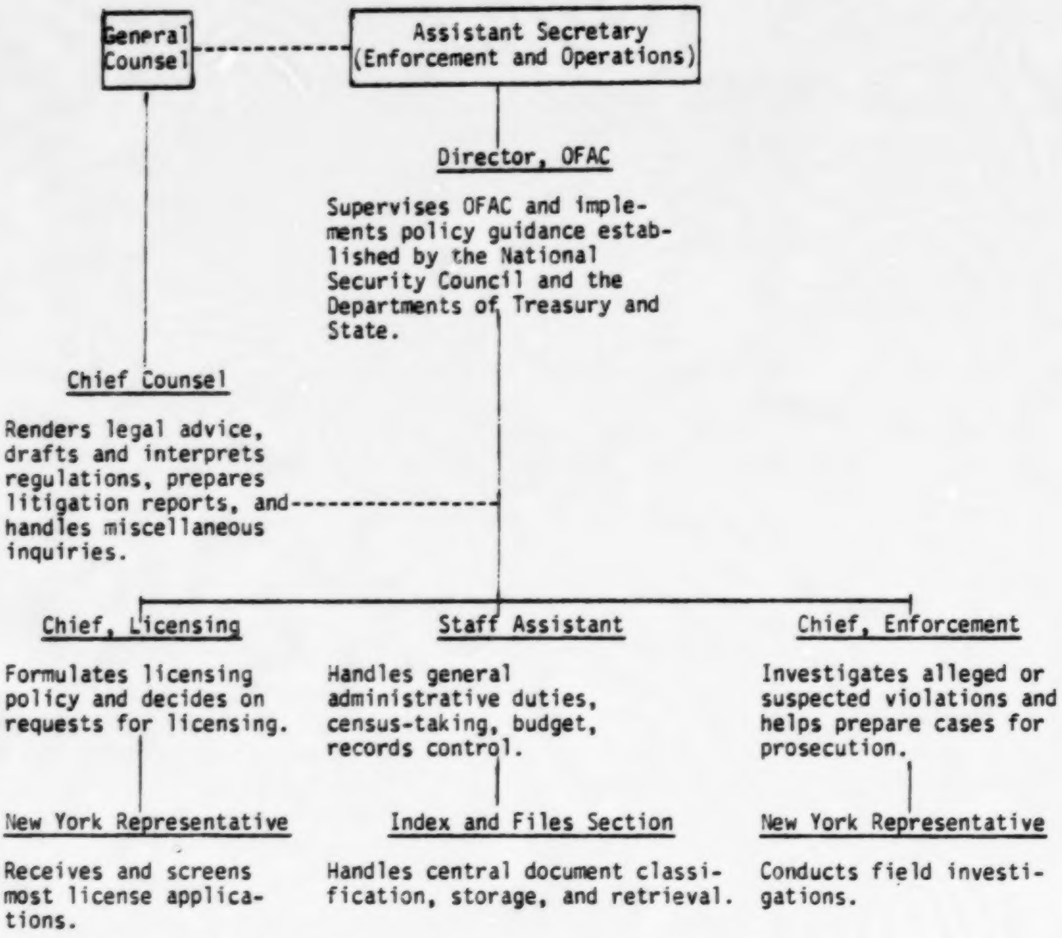
OFAC is a passive and modestly funded Treasury unit which relies heavily on the private sector to comply with its regulations. Its workload is quite unpredictable, varying greatly with such unforeseen crisis situations as Iran. Nevertheless, OFAC's continuing low profile over the years in administering blocking programs is largely responsible for the confusion which exists over what actual program results have been achieved.

ORGANIZATIONAL STRUCTURE

OFAC's organizational placement and functions have been studied periodically, resulting in several structural changes. Although it has always been an arm of Treasury, OFAC has been directed from different standpoints. Also, the Justice Department's Office of Alien Property administered residual World War II blocked assets and unsettled claims from 1947 until 1966 when that office was abolished and responsibility for those assets was transferred to OFAC.

A proposal to transfer OFAC to the Bureau of Customs was rejected in 1965 because the objectives and functions of the two organizations were different. As a reflection of its national security objective, supervision of OFAC fluctuated between the Assistant Secretary (International Affairs) and the Special Assistant to the Secretary (National Security) until December 1972. At that time, supervision was transferred to the Assistant Secretary (Enforcement and Operations) where it has remained, with funding support from the Exchange Stabilization Fund. A March 1976 Treasury study concluded that OFAC's placement was appropriate because it became involved with policy issues requiring significant and rapid actions in close coordination with State, Defense, Commerce, and intelligence community officials. Finally, in 1978, the transfer of OFAC to Customs was again considered and dropped, ostensibly because of the undesirability of layering the responsibility for the significant and sensitive policy issues which were considered likely to arise from its operations.

OFAC is headed by a Director and organized along functional lines as shown on the chart on the next page.



General Counsel

Assistant Secretary (Enforcement and Operations)

Director, OFAC

Supervises OFAC and implements policy guidance established by the National Security Council and the Departments of Treasury and State.

Chief Counsel

Renders legal advice, drafts and interprets regulations, prepares litigation reports, and handles miscellaneous inquiries.

Chief, Licensing

Formulates licensing policy and decides on requests for licensing.

Staff Assistant

Handles general administrative duties, census-taking, budget, records control.

Chief, Enforcement

Investigates alleged or suspected violations and helps prepare cases for prosecution.

New York Representative

Receives and screens most license applications.

Index and Files Section

Handles central document classification, storage, and retrieval.

New York Representative

Conducts field investigations.

MANAGEMENT AND STAFFING

The accumulated knowledge of OFAC's key staff members, some of whom have been with the Office since its origin, has no doubt been a valuable aid in discharging the work. At the same time, management and decisionmaking has become highly centralized. Also, too much reliance may have been placed on informal communication channels, because the manual recordkeeping system is poorly organized and incomplete.

Before Treasury reallocated and temporarily hired several persons to assist with the Iran work, OFAC had 13 positions plus the benefit of 6 employees funded by Treasury's General Counsel, all of them in Washington except for two in New York. Despite the long tenure of some staff members, vacancies have been a problem. For example, at the end of 1979 the Chief Counsel, who had been Acting Director since 1971, announced his retirement within a few months after being named Director. During the same period, the Office was served by an Acting Chief Counsel, who succeeded to the directorship. The "acting" situation was necessitated by the lack of a budget slot for the Director. In addition, both Washington licensing positions, the Staff Assistant, and two other clerical positions, either became vacant or were newly filled during our review.

Because OFAC has been supported through several different funding sources, including Treasury's General Counsel and the Exchange Stabilization Fund which (until Oct. 1, 1979) financed the Director's salary, it was difficult to determine its actual operating cost. However, we were given the following estimated fiscal year 1979 expenditures.

Compensation	$478,000
Benefits	45,000
Other services and expenses	66,000
	$589,000

ADMINISTRATIVE DEFICIENCIES

OFAC officials acknowledge that the index files could be substantially improved but state that the cost may be excessive. Cost considerations are also cited as the main obstacles to inventorying the assets and maintaining closer program surveillance. Some additional costs may be necessary to find out what assets have been blocked and how they are kept, but we believe that the use of better data-gathering and monitoring procedures can do much to keep this extra overhead within reasonable bounds.

Since the OFAC regulations have broad and far-reaching implications, it is incumbent on OFAC officials to prepare the regulations in such form and content that they can be readily understood by those expected to carry them out. We found that the regulations appeared to be unnecessarily complex and lacked clarity and conciseness, an assessment that others we spoke to agreed with. A number of the banks that we contacted had issued their own implementing instructions, thus increasing the possibility of varying practices among holders.

LICENSING ACTIONS BASED ON INCOMPLETE KNOWLEDGE

Through licensing, OFAC is able to be more flexible in the way it administers blocking regulations. Actions to liberalize or curtail blocking and movement of assets as well as to decide individual transactions are made on the basis of what is construed to be in accord with the national policy or interest. Assets are normally not unblocked unless there is a change in policy or in the owner's status. The licensing policies customarily established for debiting blocked accounts are designed to permit licenses to be issued or denied on the basis of general policy criteria. Thus, the facts presented in specific license applications customarily do not receive detailed review and verification for the purpose of making decisions. Also, as previously discussed, OFAC does not determine the effects of its general licensing policies nor whether holders adhere to their requirements; therefore, it cannot evaluate the actions resulting from such policies relative to discretionary asset conversions, transfers, account service charges, and the like.

In addition, OFAC's procedures for processing specific license applications can be improved. OFAC maintains a liaison field office at the Federal Reserve Bank of New York which is staffed by a full-time professional and receives most of the license applications. Because the applications are generally too complicated for field decisions, the New York office refers almost all of them to Washington headquarters. Decisions are routed through the New York office again instead of directly to the applicant. Processing time for an application is estimated at 2 to 4 weeks, but it occasionally takes much longer. The financial community has been critical of the time necessary to process license applications, much of which is absorbed by the mail transmissions and the duplicate recordkeeping.

OFAC officials defend the use of the New York office, at least for the present. They say that there would be no budgetary advantage in moving the office to Washington and the New York staffer has done much to facilitate resolution of problems in the aftermath of the blocking of Iranian Government assets. Nevertheless, moving the office to Washington would expedite decisionmaking and could be considered after the Iranian crisis eases.

SPARSE ENFORCEMENT ACTIVITY

OFAC's enforcement activities consist mainly of checking out suspected or alleged violations and assisting the Justice and Treasury Departments in related legal proceedings. Heretofore, the only penalty which could be applied to known prohibited unblocking transactions was criminal prosecution for willful violation of the Trading With the Enemy Act and the implementing regulations. This shortcoming was corrected with the adoption of civil penalty provisions for future blockings in the 1977 International Emergency Economic Powers Act. Because there is no provision for civil penalties for violations of the Trading With the Enemy Act and willful criminal violations are discovered infrequently in the absence of any regular program monitoring, OFAC relies heavily on the integrity of the banking and business communities to minimize or avoid abuses. Violations that have been identified have been classified by OFAC officials as being of a non-willful nature and having been performed by persons and firms not familiar with the blocking regulations.

Administratively, the regulations permit OFAC to render any unauthorized debits to accounts held by banks null and void. We were informed that the Office had, in fact, required restoration of accounts for inadvertent debits in two recent instances.

Also, OFAC is able to and has used the Customs laws to obtain forfeiture of goods illegally imported from the blocked countries. It can also compel holders to use their own funds to replace lost blocked assets (though it has rarely done so), and restrict other objectionable practices.

During fiscal year 1979, investigation activity resulted in the blocking of property valued at $946,000 which had been brought fraudulently into the United States from Cuba and $134,000 was transferred from the books of a U.S. publishing firm to a blocked interest-bearing account for earnings due Cuban composers on copyrighted music. The year before, a payment of $2,844 for violation of the Cuban assets control regulations was received by the Customs Service as a mitigated penalty in lieu of forfeiture and merchandise was seized in three cases for having been imported in violation of the regulations.

According to OFAC officials, closer program surveillance would not be worth the additional cost. The Chief of Enforcement told us that there had never been sufficient staff to make routine inspections and that the small value of many individual assets simply would not justify additional inspection costs. One solution to this problem, as we recommended on p. 32, is to discontinue the blocking of small-value assets. Mainly, OFAC obtains its leads on possible violations from other U.S. agencies and departments involved in international commerce, foreign relations, intelligence, etc. The Director informed us that OFAC has effective working arrangements with the Justice Department and that no cases (with one minor exception) involving substantive legal issues had been lost since 1950. However, Justice has refused to prosecute cases in which circumventions occurred because of sensitive political or humanitarian beliefs.

Thus, the problem as we see it is not whether OFAC has the tools or the will to use them to enforce its regulations, but rather whether it possesses sufficient knowledge of the blocked assets or the holders' custodial practices to know how the program is working and what violations have occurred. Revision of OFAC's information-gathering and monitoring policies, as we propose in earlier chapters, should enable it to make better use of its enforcement capabilities.

PROGRAM EVALUATIONS NOT MADE

To our knowledge, no current formal assessments of the effectiveness of the blocking controls and OFAC's role in administering them have been made. Our only previous review of OFAC, made in 1976 on the implementation of economic sanctions against Rhodesia, concluded that, on the basis of available information, it was not possible to determine which U.S. companies complied with the sanctions. The lone recent, and possibly the only, comprehensive study of OFAC operations was made by Treasury's Office of Management and Organization in 1975-76. It concentrated on workload factors and staffing needs rather than on programmatic concerns. No periodic audits or reconciliations are conducted to validate reported blocked assets or to determine how the regulations are being implemented. We did find, however, that the blocking controls have been the subject of much attention by legislators, administrators, journalists, and the courts. From their writings, it is apparent that the regulations are exceedingly complex, controversial, and generally not well understood.

Some form of regular or periodic program evaluation is desirable if the assets are to remain frozen for any length of time, and there is every indication that the controls will continue in effect indefinitely. For such an evaluation to be useful to management, specific and measurable program objectives must exist as well as a data bank against which judgments can be made. Present application of the objectives appear to be very fluid. No strategy has been developed to monitor and interpret program results, and asset data is too incomplete to be used as a basis of control or as criteria for compelling assetholders to comply with existing regulatory requirements.

CHAPTER 6

U.S. GOVERNMENT INTERESTS NEED MORE ATTENTION

Substantial amounts of U.S. Government-funded assets have been affected by the foreign asset blockings. They include assets of U.S. agencies earmarked as assistance funds for the embargoed countries before and at the time the freeze took effect and official claims which may have arisen as a result of U.S. economic and political relations with the affected countries. Whether involuntarily blocked Government assets and claims owed can be recovered appears to depend to a great extent on the actions taken by the responsible agency administrators. Although some blocked U.S. assets have already been recovered and the potential exists for additional recoveries, other problems necessitate program adjustments to prevent similar future blockings. Continuing to exclude Government claims from settlements derived from blocked assets dims the chances for recovering such claims.

OFAC does not know which or how much of the Government's assets have been blocked. However, it is clear that U.S. agencies would have been much better able to identify their interest in such assets had OFAC kept more complete records. As it is, millions of dollars in U.S. Government-funded assets were involved when Treasury blocked Cambodia and Vietnam assets in April 1975. A joint Justice-GAO effort resulted in recovery of $7.9 million in blocked Defense Department funds. However, $15.4 million in Agriculture Department funds were caught in the blocking and more could be caught in future blockings if a 1976 GAO recommendation on title provisions in Public Law 480 agreements is not adopted. We are also recommending the recovery of at least $1.4 million worth of assets blocked in the Agency for International Development (AID) Exchange Support Fund for Cambodia.

Prior to their collapse, Cambodia and the Republic of Vietnam depended heavily on U.S. economic and military assistance, which in fiscal year 1975 exceeded $1 billion, as shown below.

	Cambodia		Vietnam
		(millions)	
Economic assistance:			
AID commodities	$ 33.1		$ 61.4
Public Law 480 commodities	88.7		22.7
Exchange Support Fund	7.1		-
Military assistance	245.5		546.0
	$374.4		$630.1

BLOCKED DEFENSE DEPARTMENT PETROLEUM PRODUCT PREPAYMENTS

On October 12, 1979, OFAC licensed the transfer from a U.S. bank of $7.9 million in petroleum product prepayments to the Justice Department, which acted as the agent for Defense. The license is the climax of over 4 years of formal requests and informal prodding by GAO and Justice in a joint effort to recover these blocked U.S. Government funds.

The funds were prepayments for undelivered commodities under a Defense scheme to circumvent the 1973 Arab oil embargo in order to continue furnishing petroleum products to the Republic of Vietnam. Defense furnished these supplies, through the Defense Attache Office in Saigon, out of appropriated funds as part of the residual supply and support activities on behalf of Vietnam after U.S. military forces were withdrawn. These prepaid amounts were blocked effective April 30, 1975, under the foreign assets control regulations. Our report, "Improper Blocking of U.S. Funds by Office of Foreign Assets Control" (ID-79-52, Oct. 4 1979) provides a history of the scheme's development and operations. The key facts in the recovery are presented below.

On May 19 and June 2, 1975, the Residual Saigon Defense Attache Office in Hawaii requested in writing that the suppliers return the prepayments made before April 30, 1975; however, no formal demand for their return was made.

One supplier immediately returned the prepayment. By letter of May 28, 1975, the second supplier refused to return the prepayment and interpreted the foreign assets control regulations as prohibiting any transaction involving the advance payments, since "it would necessarily affect an interest of the Republic of Vietnam, a designated national." The supplier further stated that it would not be in a position to release the funds until it had "more complete knowledge of the various rights and obligations relating to its business in Vietnam."

Between then and the time the funds were recovered, GAO and Justice advised OFAC on numerous occasions that the funds belonged to the U.S. Government and should be returned. OFAC officials did not respond to the advice.

On September 21, 1978, the Assistant Attorney General for Justice's Civil Division wrote to the OFAC Acting Director requesting that OFAC unblock the supplier's prepayment, plus accumulated interest, or license its release to the United

States. Attached to that letter was a detailed memorandum setting forth the origins of the moneys and demonstrating that they were at all times public funds of the United States.

On November 1, 1978, OFAC's Chief of Licensing agreed that the beneficial U.S. interest merited unblocking the funds and returning them to the U.S. Treasury. However, the OFAC Director contended that the funds were properly blocked as a technical, legal matter and kept the funds blocked.

Dissatisfied with OFAC's continued lack of response, we investigated the case further. The ensuing Comptroller General's letter to the Secretary of Defense on October 4, 1979, explained in detail the origin and implementation of the embargo circumvention scheme and the absence of any Vietnamese interest in the blocked funds. It also showed that the moneys were at all times public funds of the United States and recommended that the Secretary of Defense recover the funds.

On October 12, 1979, OFAC licensed the transfer of the funds to Justice, acting as Defense's agent. In explaining this license, OFAC's Director stated there was always sufficient Vietnamese interest in the prepayments to block them. Having explained why it considered the blocking was proper, OFAC's decision was whether or not to license the funds to Defense, since its normal policy is to keep assets blocked pending a claims settlement. On the other hand, Justice stated there was no Vietnamese interest and its informal opinion was that any Vietnamese claim for the money was very weak. The supplier wanted U.S. Government indemnification against any claims once it returned the funds. Given these circumstances, Treasury decided to license the transfer subject to any possible court actions that might declare the transfer null and void.

On October 30, 1979, the Justice Department officially requested the supplier to immediately transfer the funds to the U.S. Government on the basis of its and GAO's investigation. On November 13, Justice received a $7.9 million check from the supplier.

BLOCKED PUBLIC LAW 480 SALES PROCEEDS

OFAC has blocked $15.4 million in Public Law 480 commodity sales proceeds obtained through a forced disposal of higher valued commodities financed by the Department of Agriculture. The funds were blocked because Agriculture's commodity agreements did not provide for it to take title to commodities in exceptional circumstances.

When the U.S.-supported governments in Cambodia and Vietnam fell, large quantities of commodities financed through Agriculture and AID were in the process of being shipped to those countries. Because AID, under its agreements, did not relinquish title to the commodities until they reached their destination, it was able to either transfer to other programs or sell $29.1 million worth of those commodities destined for Cambodia and Vietnam. Sales proceeds were returned to the Treasury. Agriculture, on the other hand, could only take control of its $25.2 million of Public Law 480 commodities because the underlying agreements did not permit unilateral vesting of intransit commodities. The shipped commodities were diverted to Southeast Asian ports and sold as expeditiously as possible. This "fire sale" approach resulted in large losses; for example, a $9 million loss resulted from selling rice for an average of $183 a ton which originally was purchased for $391 a ton.

Agriculture realized $15.4 million from these sales, after selling expenses. The proceeds from the sale were blocked because the commodities were considered as belonging to Cambodia and Vietnam. The $15.4 million was deposited in the Commodity Credit Corporation's account at the Treasury and is carried on Agriculture's records as a blocked liability that can be called at any time. According to Agriculture officials, as long as the $15.4 million remains in the Corporation's account, it reduces the Corporation's need to borrow a like amount from the Treasury to assist in financing its sales operations. This, in turn, would increase the Treasury's open-market borrowings.

In our report, "Lessons to be Learned From the Management of Commodities Remaining from Terminated Indochina Economic Assistance Programs" (ID-76-48, Oct. 20, 1976), we recommended that, to avoid repetition of huge losses resulting from expeditious sales, the Secretary of Agriculture include a vesting provision in Public Law 480 agreements.

Agriculture rejected this recommendation, maintaining that OFAC regulations provide sufficient legal and practical basis for the U.S. Government to assume timely control of frustrated commodities, i.e., prior to entering Cambodian or Vietnamese territory. We disputed this assertion previously on the basis of the facts disclosed by the 1976 review. The OFAC regulations relating to timely control of frustrated commodities were relevant only to diverting the commodities to other ports and were clearly inferior to the AID title provision for disposing of the commodities and the sales proceeds. Instead of selling the commodities with clear title as AID could Agriculture's concerns with title challenges by the new Cambodian and Vietnamese Governments and the impact of this potential problem on buyers forced hasty sales transactions. The proceeds of these sales were far less than they should have been and the lack of vesting authority prevented Agriculture from permanently returning the proceeds to the Commodity Credit Corporation's account.

On the basis of the present review, we are even more convinced of the need for Agriculture to include a vesting provision in its Public Law 480 agreements. As this report amply illustrates, the administration of OFAC regulations do not provide adequate assurance that the Government would assume control of frustrated commodities in the absence of title. Also, the lack of a vesting provision in the Public Law 480 agreements could have a profound impact on future claims settlements with these countries. At the very least, the Cambodian and Vietnamese interests in the $15.4 million represent a source of funds with which to satisfy American claims. Obviously, the more sales proceeds realized, the better it would have been for the claimants. The United States should bear no responsibility for any additional liability that might be considered accruing from the expedited commodity sales. This assumes the Government's right to act in preservation of its self-interest when the foreign government designated to receive the commodities is overthrown and dissolved.

Despite these considerations, Agriculture opposes including a vesting provision in its Public Law 480 agreements that would end this costly deficiency by freeing proceeds which might otherwise become encumbered in a blocking action and thus subject to use in settling claims.

Recommendation, agency comments, and our evaluation

We reiterate the recommendation in our October 1976 report that the Secretary of Agriculture should "Include a provision in future Public Law 480 agreements which would permit the Department, under certain conditions, to take title to commodities any time before they arrive in the recipient country."

Agriculture again rejected this recommendation, repeating its belief in the validity of its response to our 1976 report. No new rationale was offered to support its position that existing safeguards were adequate.

BLOCKED EXCHANGE SUPPORT FUND FOR CAMBODIA

AID's efforts to recover the U.S. contribution to the Exchange Support Fund (ESF) for Cambodia have been stalled by the State Department. The purpose of the ESF was to finance the foreign exchange costs of commodities and services required for technical assistance and capital projects but not covered by the AID commodity import program. State has taken the position that, rather than recover the funds, the United States should treat them as a claim against a successor Cambodian Government.

Contributions were deposited to ESF accounts, established as Khmer Government accounts, in three New York banks. The U.S. contribution was made exclusively to the ESF account in one bank. Funds were periodically transferred by the bank from the ESF account to the National Bank of Cambodia account for payments of commodities and services.

These transfers were authorized by the ESF manager in Phnom Penh, who was financed by the International Monetary Fund. He managed the ESF under the policy and operational guidance of a working group composed of representatives of the donors and the Khmer Government.

On April 17, 1975, Treasury blocked all Cambodian accounts--including the $2.9 million balance of the ESF, of which the U.S. share was approximately $1.4 million. Following the capture of Phnom Penh, AID began planning the recovery of the $1.4 million. By June 1975, a plan was developed based on the termination provisions of the ESF agreement.

The agreement terminated upon expiration of the ESF, which took place on December 31, 1975. Upon expiration, ESF assets were to be divided among all the contributing governments, including the Khmer Government, in proportion to their actual contributions. The agreement is mute on whether or not a meeting of the donors is required to dissolve the ESF and to divide the assets.

On January 6, 1976, AID asked the bank to return the blocked U.S. contribution plus any accrued interest. On April 15, the bank replied it would release the funds only upon receipt of satisfactory evidence of the concurrence of each member of the working group as provided by the agreement. The bank also stated its belief that any plan of dissolution should include all the banks holding ESF accounts. For the next year, the bank and AID argued the unilateral withdrawal proposal.

AID was not the only party interested in recovering the ESF. On April 26, 1976, the Chairman of the Special Subcommittee on Investigations, House Committee on International Relations, citing information provided by GAO, asked the AID Administrator when the U.S. share of the ESF would be returned to the Treasury. On May 26, the Administrator responded by outlining AID's attempt to recover the funds and the bank's reason for refusing to release them. He stated that alternatives were being explored with State and Treasury.

On May 16, 1977, an AID official wrote State and Treasury outlining AID's efforts (concurred in by State, Treasury, and Justice) to recover the funds and the bank's refusal. The official stated that AID had proceeded as far as possible and suggested that:

1. State, through the working group, and Treasury, through the banks, should work to release the funds, or

2. Justice should consider taking legal action to recover the funds, or

3. the U.S. Government could consider the funds as part of the total claim against the Cambodian Government rather than proceed separately to recover the funds.

On June 30, 1977, the British Embassy advised the State Department that it was trying to trace the residue of the ESF. Based on the termination provision, the British calculated that they were due $38,600. The British claimed that the U.S. bank to which the British ESF contributions were made told them it had no record of any residual funds. However, AID provided the British with a draft audit of the ESF, showing that the bank had approximately $279,700 remaining.

Treasury discussed the ESF with the bank responsible for the U.S. contribution, and in November 1977, the bank agreed to release the funds upon formal written concurrence of all members of the working group, exclusive of Cambodia. On February 13, 1978, Treasury advised State and AID of this change and recommended that State obtain the consent of the other donors to dissolve the ESF and distribute the assets. However, State contends that the bank's position does not fully exclude Cambodian participation in any recovery attempt. Despite this difference in interpreting the bank's position, no one contacted the bank to resolve this difference.

On May 10, 1978, State advised AID that working group concurrence with Cambodian participation was not feasible, given the state of U.S.-Cambodian relations. Consequently, State did not support AID's efforts to secure release of the funds. Instead, it supported making the funds a U.S. Government claim to be settled at a later date. The selection of the claims option prevented any challenge to the bank's contention that a unilateral withdrawal of the funds was not allowed under the ESF agreement. State has steadfastly refused to take legal action to recover the funds if it might involve Cambodian Government participation. Thus, while State purports to agree with AID and Treasury that the ESF agreement permits unilateral withdrawal of the pro rata U.S. share of the residue, its nonsupport of AID's efforts is not in concert with rights exercisable under the termination provision of the agreement. In this connection, the U.S. Government advised the other donors in August 1976 of its plans to withdraw its contribution and none had objected.

The ESF recovery issue was dormant until October 1979, when State reviewed it as one means of funding the U.S. commitment to the Cambodian relief program. Initial plans were to call a meeting of the working group members, suggest that each member allocate its remaining contribution to the relief program, and solicit additional relief donations from the members. However, congressional relief authorizations and a better understanding of the legal constraints of reprograming these funds slackened State's interest in this plan.

Prompted by our review of blocked assets and our urgings to recover the ESF, the AID Assistant Administrator for Asia informed his counterpart at State by a May 2, 1980, memo that the time had come to review the status of the ESF recovery. While repeating the three options presented in its 1977 memo, AID said that its strong preference would be to reach agreement with the other donors on the return of pro rata shares of the ESF. AID suggested that, before reaching such agreement, the United States obtain a firm and definite assurance from the bank regarding the conditions under which it would release the funds. The AID Assistant Administrator sent a follow-up letter to State in August 1980 urging its concurrence in a proposed bank inquiry to confirm its requirements for recovering the U.S. contribution.

Four years after the agreement lapsed and the ESF was terminated, the residue of the U.S. contribution has not been recovered. AID, State, and the bank continue to differ on the procedures for recovering the funds. In the meantime, these delays reduce the Government's option of using legal means to recover the funds, providing State would allow the use of this option. Under 28 U.S.C. 2415 (1970), there is a 6-year limitation after the right of action accrues for claims for money damages based on express or implied contracts. Since the U.S. right of action accrues on January 1, 1976, when the ESF expired, it will terminate on December 31, 1981 if this statute of limitations applies.

We support AID's suggestion for recovering the prorated U.S. contribution to the ESF in line with congressional direction. We believe State's inattention to all the facts in this case and the bank's prohibiting unilateral withdrawal of the U.S. share have been the major impediments to the recovery. In our opinion, the facts fully justify a U.S. recovery of the $1.4 million ESF residual contribution. Because of the statute of limitations, the recovery should proceed without further delay.

We do not support making a claim for these funds against Cambodia, as this unnecessarily jeopardizes their recovery. It also has the practical effect of causing the United States to give up a hard asset in exchange for a claim of doubtful collectibility; even if collectible, the likelihood is that such a recovery would be for a lesser amount.

Recommendations, agency comments, and our evaluation

We recommend that the Secretary of State support the AID Administrator in recovering the $1.4 million remaining portion of the U.S. contribution to the ESF. Furthermore, we recommend that the Secretary of the Treasury and the Attorney General provide such assistance as the Administrator may require in recovering the funds.

The Department of State did not disagree with the recommended course of action although it believes that the U.S. right to recover the funds is probably not subject to the 6-year statute of limitations. The State Department views the recovery action as one to establish title to property, which is exempt from the limitation, rather than as a contract action. However, since it is not clear how a court would decide this point, the prudent course would be to avoid delay beyond the potential limitation period. AID was in general agreement with the recommendation.

POSSIBLE ILLEGAL TRANSFER OF ESF FUNDS

We found indications that $1 million was withdrawn from the ESF and partially transferred to the Cambodian chief of state prior to his exile to the United States. Treasury and State officials have not fully investigated this matter, but certain facts do point to such funds having been illegally transferred. If so, then these funds should be returned to the ESF account and the U.S. prorated contribution should be recovered.

We do not know how the alleged transfer was made. Donors made their contributions to ESF accounts at one of three New York banks. The U.S. and Cambodian contributions were made to the bank which holds $2.6 million of the $2.9 million of blocked ESF funds. As funds were needed, they were transferred from the ESF account to a National Bank of Cambodia account at the bank and used to pay for approved goods and services. The ESF manager was the only person authorized to make these transfers and payments. He denied making the transfer and stated that any transfer that may have been made would have been illegal.

Before he was evacuated from Phnom Penh on March 12, 1975, the ESF manager stated, he deposited the ESF cable keys and checkbooks at the Malaysian Embassy. The presidency of the ESF working group rotated among the donors and the Malaysian charge d'affaires was then president. With the ESF manager's evacuation, the ESF supposedly ceased operations. AID considers March 10, 1975, as the last day the manager actively occupied his position and contends that no transactions took place from this date, as plans to reestablish the ESF in Bangkok did not materialize.

Within a few days after his evacuation, the ESF manager stated he advised the banks of the ESF's suspension. The bank holding the U.S. contribution was advised of the suspension on March 13, 1975, and responded to him on March 27, that the cable keys had been cancelled. On April 8, AID cabled the banks that the ESF activity was suspended and requested that no transactions be permitted that would reduce or encumber the ESF accounts. On April 17 Treasury blocked all Cambodian assets, including the ESF. On April 29 the AID Administrator wrote the banks confirming the April 8 cables advising of the suspension of all activity in the ESF accounts.

On April 17, 1975, OFAC learned of an allegation that on April 1 the National Bank of Cambodia had directed a U.S. bank to transfer $1 million from its account to the former Cambodian chief of state's private account. OFAC immediately investigated the allegation and found that the Cambodian bank had ordered the transfer to be made in five $200,000 payments. One payment was made on April 15, or two days before OFAC's blocking of the Cambodian assets. The remaining $800,000 had not been transferred and was blocked. According to OFAC officials, the remaining $800,000 is blocked in the bank's London branch while the initial $200,000 transfer was made from the New York branch. OFAC promptly closed its investigation after finding the transfer did not violate OFAC regulations.

On September 25, 1978, the State Department's Cambodia Desk received an allegation that the deposed chief of state contended the ESF belonged to him and that he had withdrawn $200,000 from it before the blocking. No investigation of the allegation was made by State nor was it referred to OFAC.

We followed up on the alleged transfer. On November 8, 1979, we asked the U.S. bank to provide us with the 1975 Cambodian bank account statements; on December 21, 1979, we received the statements except for January and March, which bank officials said they could not locate. The April statement shows a $200,000 credit on April 1 and a $200,000 debit on April 15. We subsequently requested the ESF account statements for the same period to determine whether this account was the source of the $1 million, but the bank has not provided us with the statements.

We believe a thorough investigation of the transfer is warranted. Although $800,000 of the $1 million remains blocked in the Cambodian bank's account, it is important to know the source of funds because the United States may have a recoverable interest in the funds. If the funds were improperly transferred from the ESF, which the ESF manager concedes could have happened, their return to the ESF account would result in a larger recovery of moneys for the United States.

Recommendation and agency comments

We recommend that the AID Administrator investigate whether the $1 million transfer came from the ESF and, if so, determine whether it was made in compliance with the working group's direction. If it was not in compliance, the Administrator should seek restoration of the funds and accumulated interest to the ESF and initiate recovery action for the U.S. Government.

AID told us it had commenced examining the authority and methods available to it for implementing this recommendation.

RECOVERABILITY OF U.S. GOVERNMENT CLAIMS IMPAIRED

Most blocked assets--including the Iranian, Chinese, and the bulk of the Vietnamese and possibly other countries' funds--are either directly or indirectly government-owned and controlled. Thus, it is not surprising that some of them originated from or were financed by U.S. assistance programs. However, U.S. Government claims do not participate with private claims in vying for defrayal out of funds generated in connection with claims/assets settlements. In effect, this gives

U.S. private claimants ready access to the most dependable and convenient source of compensation while simultaneously weakening the prospects for recovery of official claims since the Government is placed in a subordinated creditor position. It also has the effect of allowing private claimants to receive a larger pro rata share of any settlement, since any compensation derived from the assets will be spread over a smaller claims pool.

The value of U.S. Government claims against the countries whose assets are frozen is generally not known. However, their value against China and Vietnam may possibly far exceed that of private claims.

China claims

The May 1979 U.S.-PRC claims/assets agreement does not cover U.S. Government claims against the PRC for outstanding debts incurred by the then-recognized government of China (Taiwan) and benefiting the Mainland for which the PRC as the successor government could conceivably be held responsible. The extent to which the PRC is responsible for any of these obligations, and the extent to which repayment is required, remain undetermined and depend on complex legal issues of state succession and international law.

In 1979, the PRC repaid the U.S. Postal Service approximately $600,000 for unreimbursed services dating back to 1949. In addition, China owes about $50 million, including interest, on Eximbank loans made in 1946 although the PRC disclaims responsibility for them. Other U.S. Government claims contracted by Taiwan preceding the establishment of the PRC regime consist of lend-lease assistance of $244 million and an obligation of $69 million for surplus property. Although the State Department has not waived its right to assert these claims against either the PRC or Taiwan, it regards their collectibility as being very uncertain. Furthermore, in 1949 and 1950 the PRC seized U.S. embassy and consular property in China valued by the State Department in 1952 at $11.2 million.

A Treasury official disagreed with our opinion that the U.S. negotiating position for the recovery of these debts was weakened by not considering them along with private claims, saying that trade policy options are levers the administration could use at any time to press the issue if recovery of outstanding claims was a matter of sufficient priority. Nonetheless, the debts have not been repaid and, to the best of our knowledge, the United States is not currently negotiating with the PRC for their recovery.

Vietnam claims

The value of U.S. Government claims against the Socialist Republic of Vietnam and its predecessor governments has not been determined. The only projection we found was a figure of $4.6 million in State Department 1977 and 1978 briefing books on U.S. normalization of relations with Vietnam. According to a Department official, the $4.6 million represents the 1950s purchase price of the U.S. Embassy property and buildings.

The $4.6 million claims figure appears to be understated because it does not include economic assistance claims (loan repayments due for AID and Public Law 480 commodities plus insurance) of at least $77 million. The State Department Legal Office believes these economic assistance obligations raise not only factual questions but also legal issues related to state succession and the liability of the Socialist Republic of Vietnam for debts incurred by the former government of South Vietnam. The United States had not waived or forgiven these debts, and it is important to consider that a significant portion of the Vietnam assets blocked apparently belongs to the Vietnamese central bank.

As a result of our inquiry on the value of U.S. Government claims against the Socialist Republic of Vietnam, State requested AID and Treasury personnel to determine what, if anything, might be due the U.S. Government from Vietnam from aid agreements, including loans, and any claims the Socialist Republic of Vietnam might be able to make for frustrated cargoes of economic assistance commodities.

AID loans

AID lists Vietnam as having $33.7 million in outstanding economic assistance loans. As noted on p. 47, AID's unilateral vesting provision allowed it to sell frustrated commodities and return the proceeds to the Treasury. Thus, these AID funds were not blocked. However, other AID-generated funds may be blocked since a variety of South Vietnam Government funds were transferred to the United States during the last weeks of the war. If so, the funds have not been specifically identified and thus remain available for settlement of claims.

Public Law 480 loans

Agriculture lists $42.9 million in outstanding food loans to Vietnam. Because it lacked a unilateral vesting provision, $5.9 million in sales proceeds from the frustrated commodities designated for Vietnam were blocked. These funds presently are not available for partial offset of the $42.9 million since, as blocked assets, they are part of the funds which might be used for settling private claims.

Overseas Private Investment Corporation insurance

OPIC has paid three small claims, amounting to approximately $1 million, for insured losses suffered by U.S. claimants in Vietnam. It has settled with one bank and is settling with a second bank and estimates it may be liable for additional claims not exceeding $11 million resulting from these claims. Claims resulting from payments made to insured private claimants do not need to be validated by the Foreign Claims Settlement Commission and agreement has been reached with congressional and State Department staff to allow OPIC claims to be recognized along with private claims in any future settlement.

Iran claims

A census of U.S. claims against Iran was in process in mid-1980. Although Government claims were supposed to be included in the census, we are not certain that all such claims were being reported (see app. II). Moreover, their recovery could be affected significantly by how they would be treated in a settlement predicated on the existing blocked assets. For example, OPIC's expropriation and inconvertibility insurance exposures in Iran are over $50 million. Thus, it is possible that OPIC could be subrogated eventually to claims against the Government of Iran in the tens of millions. OPIC seeks to be able to participate in any distribution disposing of claims against Iran as though OPIC were a private party rather than a U.S. Government agency.

Conclusion

The U.S. Government should determine the full extent of its claims against the Socialist Republic of Vietnam and other countries whose assets are blocked, and the amounts should be made known to the Congress during any legislative considerations of claims validations and settlements. Ideally, blocked U.S. Government proceeds, such as those derived from the Public Law 480 sales, should first be used to offset U.S. Government claims originating from the same program. Other Government claims should be considered as participating equally with private claims in any settlement funded with blocked assets. Quite simply, if the current regime in Vietnam should be able to lay claim to the blocked assets by assuming the position of the predecessor government, then by the same token it ought to assume that government's liabilities.

Recommendations, agency comments, and our evaluation

We recommend that the Secretary of State:

--Identify and fix the value of U.S. Government claims against Vietnam and other countries whose assets are blocked and include these claims in any settlement funded with blocked assets.

--Ensure that blocked U.S. Government proceeds originating from its assistance programs are first applied to related program claims against affected countries.

The State Department agreed that the full extent of claims against blocked countries be determined and that certain Government claims be given priority against matching assets; but disagreed that government claimants otherwise participate in assets-funded settlements because of the difficulty of concluding them on terms acceptable to private claimants and the Congress. We reject this rationale since it leaves government claimants in a subordinated creditor position to private claimants.

CENSUS OF BLOCKED IRANIAN ASSETS AND U.S. CLAIMS AGAINST IRAN

On April 7, 1980, in conjunction with the breaking of diplomatic relations with Iran, President Carter announced a series of economic sanctions supplementing the November 14, 1979, blocking of Iranian Government property and interests. They included ordering the Secretary of the Treasury to make a formal inventory of the previously frozen assets and a census of the outstanding claims of American citizens and corporations against the Government of Iran. The information was to be used to monitor compliance with the Iranian assets control regulations and to design a claims program against Iran for the hostages, their families, and other U.S. claimants.

Pursuant to the President's announcement, OFAC amended its regulations to impose one-time reporting requirements on individuals and firms to list blocked assets held between November 14, 1979 and March 31, 1980, and to describe claims against any Iranian Government entity which arose before April 15, 1980. Filing instructions and forms for each census were distributed and a filing deadline of May 15, 1980, was established, with no extensions being permitted.

OFAC set up an Iran Census Unit to process the reports. The Unit, headed by the Staff Assistant, consists of six reviewers and a secretary detailed from other Treasury offices or temporarily hired for the task. No date for completing the census was set, but OFAC officials estimated that a tabulation of the claims would be ready by September 1980, followed by one on the assets a month or two later. The claims reports were being processed first for planning purposes inasmuch as the approximate magnitude of blocked assets was obtained by surveying major holders immediately following the blocking.

CLAIMS CENSUS

The Iran census marks the first time that OFAC has been formally engaged in gathering claims data. In the past, such informal claims surveys have been made by the State Department in advance of formally authorized claims adjudication programs conducted by the Foreign Claims Settlement Commission. Although the census form instructs a prospective claimant that the report does not constitute a filing for compensation, it also cautions that failure to submit complete and timely information will create a breach of Treasury Department regulations which make the claimant subject to civil penalties and which may be prejudicial to the claimant and other U.S. claimants.

No decision has been made as to whether a formal claims adjudication program will follow, but legislation to that effect is being drafted for possible congressional consideration.

Processing of the claim forms was nearly completed as of August 1980. Because of the short (approximately 30 day) filing period, reports received after the May 15 deadline were considered until all of them--submitted by over 3,200 individual and corporate claimants--had been reviewed. The reports were reviewed only for accuracy, consistency, and completeness; claim amounts were not altered or judged as to their merit other than to show separately those losses actually incurred whose value could be definitely fixed and which occurred on or after October 1, 1978 (advent of the Iranian revolution). No supporting documentation was required, no validation procedures were in effect, and discretionary valuation criteria was presented, in the general instructions. As a result, while that the census results may contain inflated values in a number of instances it should aid in affirming the broad magnitude of U.S. claims against Iran.

For example, we learned that the value of claims for intangibles (such as personal injury, mental or emotional stress, and future employment considerations) often far exceeded the amounts claimed for other types of property. In addition, only some U.S. Government claims (including OPIC and Eximbank but excluding State and Defense Department installations and equipment) are reflected in the census. Undetected dual reporting of claims by syndicated or related U.S. business enterprises and by individuals could also affect the reliability of the census; however, reports are being cross-checked to reduce this possibility.

ASSET CENSUS

This census is intended to assist in (1) determining whether blocked asset values are sufficient to cover any existing claims (or those which arose since October 1, 1978, if Congress chooses to limit qualifying claims) and (2) establishing a data base with which to monitor compliance with the Iranian asset control regulations. The reporting format is different, but instructions to asset custodians and procedures for report review are similar to those used for claimants. Processing of the asset reports commenced after all the claims had been reviewed. As of the end of July 1980, over 350 holders, reporting separately for each account and a listing each type of asset held, had submitted the required data.

The asset data is expected to be more reliable and useful than that obtained for claims, though it is also subject to some variance. For example, certain types of assets posed valuation problems, such as used communications equipment sent back to the U.S. manufacturer for repair; and dual reporting of an asset was possible when more than one party was responsible for it or when the property was in transit during the reporting period. The census would not reflect transactions licensed after March 31, 1980. Nonetheless, assuming that U.S. holders adhere to OFAC's reporting requirements, the data acquired should be sufficient to make some meaningful assessments with regard to coverage of the associated claims against Iran.

However, we are not as confident that the asset census will provide an adequate data base to enable OFAC to monitor compliance with its regulations. The property required to be reported is controlled only by holder, type, and amount--not by account number or other identifying symbol through which changes in value, form, or custodian can be traced over time. Such changes are bound to occur under OFAC's licensing policies which (1) permit owners limited discretion in determining how their assets should be invested, (2) require holders to pay interest on deposits, and (3) allow unblockings in some specific instances. Moreover, no provision was made for periodic updating or reconciliation of the census data. In these circumstances, the data base provided by the census unless updated will prove to be of temporary usefulness and a marginal tool for monitoring regulation compliance.

USE OF BLOCKED ASSETS TO OBTAIN CLAIMS SETTLEMENTS

Blocked assets have frequently been used as a basis for claims settlements with foreign governments and as a fund for compensating claims arising from the nationalization or other unlawful takeover of American property. The value of settlements appears to vary significantly, depending on the magnitude of blocked assets, types of settlements, and when settlements are made. Because most settlements either directly or indirectly reflect blocked asset values, it is to the claimants benefit that these values be preserved or increased. Lump-sum cash settlements, such as the one negotiated with China, are considered to be the best form of settling claims disputes. Finally, since blocked assets over time have been declining in value at the same time that adjudicated claims increase because of the inclusion of interest in awards, the earlier that settlements can be completed the better it is for the American claimants.

Settlements have usually been for less than the full value of claims, even disregarding interest. Post-World War II settlement agreements with five East European countries have involved varying percentages of the face value of the awards adjudicated by the Foreign Claims Settlement Commission, as shown below.

Claims Programs Under International Claims Settlement Act of 1949, as amended

Country	Completion date	Approximate amount of award paid
Yugoslavia	Dec. 31, 1954	91 %
Yugoslavia (second)	July 15, 1969	36.1%
Poland	Mar. 31, 1966	33 %
Bulgaria	Aug. 9, 1959	$1,000 plus 69.7%
Bulgaria (second)	Dec. 24, 1971	$1,000 plus 69.7%
Hungary	Aug. 9, 1959	$1,000 plus 1.5%
Romania	Aug. 9, 1959	$1,000 plus 37.8%
Romania (second)	Dec. 24, 1971	$1,000 plus 37.8%

The funds to pay claims for Bulgaria, Hungary, and Romania were derived from the vesting and liquidation of government assets which had been blocked by the United States. In addition, the United States and the Soviet Union agreed to settle certain pre-World War II claims by assigning to the United States the assets due the Soviet Government as the successor of prior governments of Russia (Litvinov Assignment, 1933). The assignment resulted in an approximate payoff of 10 percent of the value of American claims.

The possibility is slight that claimants could successfully litigate against the U.S. Government for negotiating less than a full settlement since, in the absence of insured losses, the United States is not legally required to compensate its nationals for differences between the amount of adjudicated claims and the actual amounts realized from the settlements.

CHINA

U.S. officials negotiated a claims/assets agreement with the People's Republic of China in May 1979. The agreement provides for payment to the United States of $80.5 million in consideration of its unblocking all assets identified as being linked to the PRC which remained blocked as of March 2, 1979. The U.S. proceeds, $30 million paid on October 1, 1979, with the remainder to be paid in five annual installments of $10.1 million commencing October 1, 1980, will be used to settle U.S. claims against the PRC since its establishment on October 1, 1949, and the date of the agreement.

Private claims arising before November 1966 have already been adjudicated by the Foreign Claims Settlement Commission, resulting in 384 certified claims amounting to $196.9 million. Claims originating after November 1966 remain to be adjudicated but are expected to be negligible. Thus, after the statutory 5-percent fee for administrative expenses is deducted, the private U.S. claimants will receive something less than 40 cents on the dollar--unadjusted for 30 years' inflation--with no provision for interest. Moreover, U.S. Government claims, which are estimated to exceed the value of private claims, were excluded from the settlement.

The $80.5 million to be paid by the PRC corresponds exactly with the official U.S. estimate of Chinese assets blocked at the time the agreement was concluded. In a sense, obtaining a lump-sum settlement was to the claimants' benefit. Treasury officials estimate that the realizable value of the Chinese assets would have been far less had they been vested rather than unblocked for cash because of collection problems on assets belonging to third-country banks and residents, adverse claims, and so on. Moreover, the $80.5 million OFAC estimate of blocked Chinese assets which served as the basis for the settlement has not been verified. We found that one bank, which OFAC estimated to have $1.1 million based on the 1970 census, had only slightly more than half this amount of assets blocked in 1979.

However, it can also be argued that the settlement should have been much larger. Treasury has determined that 70 percent (or about $53 million) of the blocked assets identified in the 1970 census consisted of deposits held by banks in the United States, largely in non-interest-bearing demand deposits; the demand deposits would have yielded more than $200 million had they been placed in compound-interest-earning accounts when they were blocked rather than waiting until 1979 to do so, which would have been sufficient to pay off the full principal value to American claimants. In addition, recovery was not made of the more than $10 million in assets which could not be accounted for in reconciling the 1970 census with the 1951 census.

Treasury regards disposition of unblocked assets to be a matter between asset-holder and owner. In keeping with a position of neutrality, U.S. officials have steadfastly refused to reveal the identities of the holders or owners to the PRC. However, it is reasonable to assume that the PRC will attempt to lay claim to possibly all of the assets. In fact, at the PRC's request, the unblocking of the assets was delayed 4 months, to January 31, 1980, to give the PRC's attorney more time to resolve unforeseen legal problems; also, a 2-year moratorium has been placed on the transfer of assets to State abandoned property offices to give the PRC a better chance to recoup them.

CZECHOSLOVAKIA

Claims of U.S. nationals against the Government of Czechoslovakia for the nationalization or other takeover of property from January 1, 1945 to August 8, 1958, have been adjudicated by the Foreign Claims Settlement Commission. This program, which was completed on September 15, 1962, resulted in certified awards amounting to $113.6 million. Claims arising after August 8, 1958, have not been adjudicated, and new filings are still being accepted. No determination of the amount or location of blocked Czech assets in the United States has ever been made.

The United States and Czechoslovakia attempted unsuccessfully in 1960 and 1974 to negotiate claims settlement agreements. Agreement was reached in principle in 1974 to settle U.S. claims for $29.5 million but was not finalized because of congressional objections to another feature of the agreement.

Thus far, $8.5 million derived from the vesting and sale of certain blocked Czech assets have been used to make payments on awards and for administrative expenses.

CUBA

A Foreign Claims Settlement Commission program to determine the amount of valid American losses in Cuba commenced on November 1, 1965, and was completed on July 6, 1972. The Commission certified nearly 6,000 claims totaling more than $1.8 billion. The method of payment for the losses was examined before legislation was enacted authorizing the claims program. Initially, a provision was included which would have allowed Cuban assets in the United States to be liquidated and the proceeds made available for payment on the losses. However, a study by the Departments of State and the Treasury concluded that the assets were not sufficient to warrant such action and the provision was deleted from the legislation.

A 1964 OFAC census of blocked Cuban assets disclosed a total value of $148.8 million. However, approximately half of the assets were regarded as worthless because they consisted of bonds secured by property in Cuba. The assets are currently estimated at $30 million.

No settlement of American claims against the Government of Cuba has been made or is known to be in the process of negotiation.

GERMAN DEMOCRATIC REPUBIC

A Foreign Claims Settlement Commission program to receive and determine the claims of U.S. nationals against the German Democratic Republic resulting from nationalization or similar takeover of property commenced on May 16, 1977, with publication of a notice for a one-year filing period. Under specific statute provisions, the Commission must complete all claims determinations not later than 3 years after the filing deadline--May 15, 1981. No provision was made for how the claims were to be settled. The value of blocked East German assets has not been determined precisely but is probably insignificant in relation to those of American claims.

VIETNAM

A bill to authorize the Foreign Claims Settlement Commission to receive and determine private American claims for property confiscated by the Socialist Republic of Vietnam was introduced in the U.S. House of Representatives in February 1979. The purpose of the program is to allow the claims adjudication process to proceed at a time when the best possible evidence exists and the Commission's determinations would be available if the United States enters into claims settlement negotiations. The proposed legislation, which cleared the House in May 1980, contemplates a 2-year filing and a 3-year settlement period in which to review and validate the claims.

Only limited information is available on the value of blocked Vietnamese assets, which consist of holdings of Republic of Vietnam nationals at the time of and subsequent to the Communist takeover in April 1975. No formal census of these assets has been conducted; however, a telephone survey conducted in late 1975 (and revised in 1976) of Vietnamese accounts in excess of $50,000 disclosed $99.3 million blocked at major banks in the New York and San Francisco Federal Reserve districts and at one Illinois bank. In addition, Treasury views a $40-million blocking and subsequent conditional unblocking of a European bank's assets, representing an offset for Vietnamese-originated dollar currency deposited in the United States as an asset available to satisfy claims; the validity of the blocking is expected to be determined in the U.S. courts.

The value of blocked Vietnamese assets has been estimated to exceed U.S. private claims. In testimony on the Vietnam claims bill during July 1979, the Chairman of the Foreign Claims Settlement Commission estimated total private claims at $110 million. At the same time, Treasury's General Counsel testified that an estimated $140 million in Vietnamese assets were blocked. Because we found Treasury's estimate to be significantly overstated and because it may be unrealistic to fully offset one with the other, the conclusion should not be drawn that blocked assets are sufficient to cover existing private claims.

Also, U.S. Government claims against Vietnam have not been determined but are believed to be substantial.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

OCT - 8 1980

Dear Mr. Anderson:

The Department of the Treasury appreciates the opportunity to comment on the draft GAO report concerning the Office of Foreign Assets Control (OFAC). The draft includes a number of constructive observations and suggestions which we will seek to adopt. In addition, however, it also contains some material which we question and which is discussed in this letter and in the attached annex.

One of our basic concerns is that, while the draft report purports to describe an existing situation, it does not deal with what OFAC now does or how it operates, and has operated for nearly a year. Instead, it is based on an audit conducted in the spring and summer of 1979. The criticisms in the draft report are that insufficient attention has been given to monitoring the status of the blocked assets, excessive time transpired before interest requirements were imposed, too many small individual accounts were blocked and unnecessary confrontation has taken place with our allies over the overseas applicability of our blocking orders. In each of these areas, however, the Iranian sanctions (now constituting the bulk of OFAC's activity) have been implemented so as to eliminate or minimize to the extent possible any problems. These activities, and other steps, have for the most part mooted the central thesis of the proposed report, i.e., that Treasury should improve its monitoring of blocked assets and take other steps to enhance their value. The report should thus make clear that it does not deal with how Treasury has administered the Iranian freeze.

The central thesis of the proposed report is that Treasury should improve its monitoring of blocked assets and take other steps to enhance their value. The draft, however, insufficiently describes steps also already taken in the non-Iranian context to deal with these concerns.

In November 1978 (well before the GAO audit commenced), rules were proposed (and later promulgated in March 1979), to require that all assets blocked under the various regulations administered by OFAC earn interest. While GAO suggests that this should have been done earlier, the fact is that this Administration, on its own initiative, did undertake this major

GAO note: Treasury requested that we substitute this letter for one dated August 18, 1980, in order that Treasury views be fairly presented. This does not alter any of Treasury's previously stated positions but adds some points from an attachment not printed because of its length. The substitution did not delay issuance of the report.

reform in the manner in which blocked funds were handled. Previously, OFAC has relied on the existence of a general license permitting a blocked national or government to direct the investment of their own blocked assets in securities or certificates of deposit. These new provisions were significant to the entire program. They applied not only to blocked assets of China but to those of the nine other countries affected by OFAC's regulations.

In addition, in connection with the interest proposals, Treasury also dealt with the state abandoned property law issue discussed in the draft report at pp. 46-49. After reviewing (p.33-34) comments in connection with a proposed rule, Treasury concluded that a summary and complete withdrawal of the licensing policy probably was not warranted. On the other hand, Treasury redrafted the licensing provision to make explicit and clear that states would be required to meet indexing and recordkeeping requirements, and to comply with the interest regulation, before either a new license would be issued or a suspended license reinstated. This approach preserves, and reflects good management of, the assets.

Treasury agrees with GAO's view as discussed on pages 21-23 (pp. 15-16) of the report that more complete information about blocked assets is necessary. Prior to the GAO audit, Treasury also commenced action to supplement earlier censuses of the various assets and improve the data base regarding all blocked property. A new Treasury form (TFR-611) was developed to survey all property subject to the new interest regulations. Announced in March 1979, substantial time was devoted to completing the form and instructions. Treasury has deferred requiring this report, because the Iranian blocking required both OFAC and the involved private institutions (which are similar for all programs) to give priority to the extensive reporting requirements under that freeze. Once the census of Iranian claims and assets is complete, this form and the accompanying reporting requirements will be promulgated.

In addition, Treasury intends to review the cost estimates (mentioned on page 22 of the report) for conducting an overall census of blocked assets. (p. 15)

Treasury will also consider the suggestion that OFAC adopt a requirement for periodic updating by census-reporters. However, serious resource questions must be resolved before such a program is undertaken.

The proposed report's treatment of OFAC's data base and data-gathering activities is disturbing in regard to the discussion of blocked Vietnamese assets. Here, the report entertains a number of assumptions as to why the assets are probably less than Treasury's estimate, without substantiation and without acknowledgment that the Vietnamese assets pool may, in fact, exceed that estimate. In other words, the proposed report seems to argue on the one hand that a census is necessary to determine Vietnamese asset values with accuracy, while on the other hand it purports to determine the value of assets -- but without benefit of such census data.

In this regard we object to GAO's use of the Vietnamese assets situation as a "good illustration" of estimates of blocked assets being overstated and of misleading impressions being conveyed of the value of blocked assets for claims settlement purposes. The Vietnamese assets have never been the subject of a census. Treasury's estimate of their value is no illustration of, for example, the quality of our data on the Iranian assets and claims, now the subject of a thorough, on-going census; nor does it typify the data on Chinese assets, the subject of two censuses, the later summed up in a detailed public report, or the Cuban assets, also the subject of a detailed public report.

The reports of the 1970 Chinese census and the 1964 Cuban assets census each gave a very detailed breakdown of the assets and pinpointed a number of contingencies that would caution against any conclusion that "the value of blocked assets has a corresponding value for the purpose of settling claims." The Chinese report identified, both conceptually and in dollars-and-cents terms, such factors as third country bank interest in the assets, beneficial ownership by Americans, beneficial ownership by unblocked nationals, adverse claims by Taiwan and other parties, and other factors that would bear on the value of the assets for claims settlement purposes.

The draft report also is critical of the overseas application of U.S. freezes. Initially, Treasury seriously questions whether the audit of the operations of CFAC is the proper vehicle to address this issue. The extent to which U.S. economic sanctons should apply to branches and subsidiaries of American companies operating outside the U.S. is clearly a difficult and controversial issue. While there is no genuine question about the legality of such actions, policymakers considering how to proceed must balance numerous factors -- economic and diplomatic -- in determining the appropriate scope of particular sanctions. Since this subject generally was outside the purview of this audit, the audit team apparently has not undertaken the extensive historical, political and economic analyses necessary to analyze the impact of extraterritorial application of varying types of sanctions. It would therefore seem appropriate to delete from the draft the discussion of this issue.

The problems in the draft report's analysis of the overseas freezing issue is evidenced by its treatment of a recent $40 million blocking action. Initially, GAO reviewed numerous classified materials on this issue and there is some question about the extent to which this case should be discussed in an unclassified draft. In any event, the draft report misdescribes the case.

This case was not based on extraterritorial application of U.S. laws to activities transpiring in a foreign country. On the contrary, the case involves the illegal physical transmitting of $40 million in cash into the United States by a foreign bank acting on behalf of the owner of the currency, the Government of Vietnam. Thus money was blocked immediately upon its being brought to the United States and deposited in banks here. Later attempts to transfer the money back to the foreign country where it could be credited to the Vietnamese accounts were plainly null and void under existing regulations. The foreign bank which used its accounts in the U.S. to transmit these blocked funds was thus held accountable for them and $40 million of its funds were blocked. It is thus highly questionable for the draft report to rely on a case involving the "laundering" of funds through the domestic U.S. banking system as the main example showing why we should not block the overseas branches of U.S. banks.

Particularly troubling, is the critical tone of the discussion of Treasury's resolution of this blocking. It agreed to accept fully secure substitute security for the blocked account. This avoided unnecessary litigation, minimized potential disagreements with another country and fully protected U.S. claimants. Treasury lawyers, including the Deputy General Counsel, reviewed all the relevant documents and were confident that this interim agreement would not materially alter the situation that existed prior to the agreement; it merely forestalled the possibility of immediate litigation.

The draft report also ignores significant resource issues. Few could argue that there would be no benefits from increased reporting, more detailed OFAC recordkeeping and more frequent censuses of blocked property. However, the improvements that GAO seeks are not only a matter of desirability, but involve questions of resource availability. GAO urges many reforms on OFAC without relating them to present organizational capacities or future personnel, budget and equipment needs. The draft report wrongly assumes that resources are unlimited and there is no need to compete for them with other programs which also have desirable benefits.

Finally, I wish to address the allegation that an unwillingness on the part of Treasury to share relevant documents with the audit team impaired the progress of the audit and is somehow responsible for inadequacies in the results obtained.1/

The suggestion that GAO was restricted is completely unfounded. On the contrary, while differences of opinion did arise during the audit the audit team consisting of four individuals had extremely extensive access to OFAC files going back thirty years under procedures agreed upon with Treasury. This was allowed even though, as the draft reveals, the scope of the audit was constantly expanded.

As far as the timeliness of the release of documents is concerned, the audit team took approximately eight months to complete the report after completing its audit. Thus it can hardly be said that the time required for Treasury review was a material problem. Also, the audit team never came to us with any suggestion that it believed that there was more in the record on any point which it was not able to see; nowhere in the proposed report itself is there any such suggestion tied to any time with a request to cure any suspected gap in the documentary record.

These are some of Treasury's overall observations on the GAO report and on Treasury activities involving the maintenance of information about those assets. More detailed comments are

1/ Comments in the draft report relating to access to Treasury records were deleted from the final report. Despite restrictions on our audit staff, we believe that sufficient documentary and oral evidence was obtained to support our conclusions and recommendations.

included in the Annex. As mentioned above, we would like to discuss our comments with GAO prior to the preparation of any final report.

Sincerely,

Richard J. Davis
Assistant Secretary
(Enforcement and Operations)

Mr. William J. Anderson, Director
General Government Division
U.S. General Accounting Office
Room 3866
441 G Street, NW
Washington, D.C. 20548

DEPARTMENT OF STATE
Comptroller
Washington, D.C. 20520

July 17, 1980

Mr. J. Kenneth Fasick
Director
International Division
U.S. General Accounting Office
Washington, D.C.

Dear Mr. Fasick:

I am replying to your letter June 17, 1980, which forwarded copies of the draft report: "Treasury Is Not Aware Of The Foreign Assets It Blocks"

The enclosed comments on this report were prepared by the Acting Deputy Assistant Secretary for International Finance and Development.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

Roger B. Feldman

Enclosure:
As stated

GAO Draft Report "Treasury Is Not Aware Of The Foreign Assets It Blocks"

The Department of State welcomes the opportunity to comment on the subject GAO draft report. While the major issue discussed in the report is the management of blocked foreign assets, the report also makes recommendations regarding the handling of United States Government claims against foreign countries, citing specific examples in Cambodia and China. Settlement of these claims is of particular interest to the Department of State.

The Government Accounting Office position seems to be that the United States Government claims have not received sufficient attention in the United States Government claims settlement activities. The study makes three related recommendations: (1) it recommends that the Secretary of State determine the full extent of United States Government claims against Vietnam and other countries with assets blocked in the United States. The Department of State concurs therein. (2) The study takes the position that the United States Government claims should have priority against any blocked assets derived from United States assistance programs or other similar United States Government activities. The Department of State agrees. (3) The study urges that the United States seek settlement of government claims against foreign governments with the settlement of United States private claims and that the United States Government claims share in any settlement funded with blocked assets. The Department of State disagrees. Traditionally, private and government claims have been treated separately and are, for the most part, the subject of separate claims agreements. Adoption of this recommendation would make it extraordinarily difficult in many cases to conclude settlements of private claims on terms acceptable to the claimants and the Congress.

Exchange Support Fund For Cambodia

The discussion of this subject is generally accurate and I have no serious quarrel with the course of action recommended. I believe, however, that the report is inaccurate in two instances. On page 77 there is a statement that the Department has taken the position that unanimous concurrence of the working group is necessary prior to (p.50) withdrawal of funds from the ESF account with the Irving Trust Company.. This is the position which Irving Trust has taken; the Department has never supported it and, in fact, agrees with AID and Treasury that the ESF agreement permits unilateral withdrawal of the pro rate U.S. share of the residue. Irving Trust has refused to accept this interpretation of the agreement and initially requested action by all members of the working group, including Cambodia. The Department took the position that such action as impossible because of the state of the relations with Cambodia. Irving Trust appears to have changed its position in November 1977 (although some ambiguity remains). As the report notes, an effort is currently underway to ascertain the precise conditions under which Irving Trust will release the funds, and to determine whether these conditions can be met.

The statement that the U.S. right to recover these funds will expire on December 31, 1981 by virtue of statute of limitations contained in 28 U.S.C. §2415 is probably incorrect. Subsection (c) of §2145 states:

> "Nothing herein shall be deemed to limit the time for bringing an action to establish the title to, or right of possession of, real or personal property."

I believe that this exception to the general 6-year statute for cases seeking money damages on the basis of express or implied contracts governs the present case.

China Claims

The discussion of U.S. Government claims against China on page 77-78 of the draft report does not reflect the (p.54) considerable uncertainty which exists regarding the respective responsibilities of the Taiwan authorities and the PRC for these debts. We have raised the 1946 Eximbank debt with the PRC, but the PRC disclaims responsibility. We have agreed to defer resolution of this matter for the time being. The other claims mentioned in the report raise very difficult questions both of fact and of law. Although the Department has taken no definitive position and has not waived its right to assert these claims against either the PRC or Taiwan, there exists considerable doubt about the responsibility of the PRC for the lend lease and surplus property debts contracted by the ROC. The $500 million Treasury credit extended in 1942 was not by its terms repayable and is not carried by the Treasury as an obligation owed to the U.S. Furthermore, with the exception of the Exim loan, the amount of each of the other claims is subject to dispute. I believe the report should reflect the considerable uncertainty which exists concerning the PRC's responsibility for these obligations. For these reasons, as well as the general observations on the settlement of U.S. Government claims noted above, the Department does not agree that U.S. Government claims should have been included in the claims agreement with the PRC.

Michael Ely

Michael E. C. Ely
Acting Deputy Assistant Secretary
for International Finance and
Development

Drafted:L/C:FKwiatek; L/EA:TFortune:pmw:7/17/80

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EA/PRCM:RGoldberg

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

AUDITOR GENERAL

14 JUL 1980

Mr. J. K. Fasick, Director
International Division
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Fasick:

Thank you for providing the draft General Accounting Office report, "Treasury is Not Aware of the Foreign Assets It Blocks," for comment. The report has been reviewed with interest by the responsible offices. Provided herein are the Agency comments provided by the Office of Financial Management in conjunction with the General Counsel.

> "AID has reviewed Chapter 6 of your draft report to the Congress on 'Treasury is Not Aware of the Foreign Assets It Blocks.' We are in general agreement with the section of the report and with the recommendations contained therein. AID is now examining the authority and methods of investigation available to the Agency for implementation of your recommendation concerning a possible $1 million Cambodian ESF transfer."

We would appreciate your consideration of these comments in preparing your final report.

Sincerely yours,

Herbert L. Beckington

DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

July 29 1980

Mr. Henry Eschwege
Director
Community and Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

We have reviewed your draft report to the Congress on "Treasury is Not Aware of the Foreign Assets It Blocks." We are limiting our comments to the section of the report regarding blocked Public Law 480 Sales Proceeds.

We do not agree that a valid comparison can be made between the agreements under Title I and Title II of Public Law 480. Title I operations involve commercial transactions between United States exporters and foreign importers for which financing is provided to the exporter, after delivery of commodities, with funds appropriated by the Congress. Title II operations involve donations of commodities owned by the United States to foreign recipients. Also, we do not agree that the fact that this Department did not have title to the commodities exported under Title I of Public Law 480 had any effect on the amount of sales proceeds realized from sale of the commodities or that the timing of the sales constituted a "Fire Sale" approach to disposition, when in actuality we prevented an even greater loss.

We believe that the opinions expressed in our response to your October 1976 report are still valid.

Sincerely,

Bob Bergland
Secretary

U.S. Department of Justice

JUL 22 1980

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This letter is in response to your request to the Attorney General for the comments of the Department of Justice (Department) on your draft report entitled "Treasury is Not Aware of the Foreign Assets It Blocks."

Since the recommendations of the report are addressed to the Secretary of State and Secretary of the Treasury, we are deferring comment on the substantive issues involved to the respective agencies. However, we have reviewed the draft report in its entirety, and in addition to providing some general observations, noted certain inaccuracies which you may wish to consider in finalizing the report. Our comments are referenced to the pages to which they relate.

1. Pages 1-4, LEGAL AUTHORITY. The draft report suggests that the executive branch is presently exercising broad powers under Section 5(b) of the Trading with the Enemy Act, as amended, 50 U.S.C. App. 5(b). That section was amended by Congress in 1977 by removing the President's authority to invoke the Act in times of a national emergency. (Public Law 95-223, Title I, Section 101(a), 91 Stat. 1625, 50 U.S.C. App. 5(b).) The trading with the Enemy Act is now strictly a wartime measure. The President's powers to regulate international economic transactions in time of a national emergency proclaimed after 1977 are derived solely from the International Emergency Economic Powers Act. (Public Law 95-223, Title II, Sections 201-208, 91 Stat. 1626, 50 U.S.C.A. 1701 et seq.) The exercise of those powers is subject to a variety of limitations imposed upon the President by the National Emergencies Act. (50 U.S.C. 1601 et seq.) It is correct that the freezing controls which were imposed prior to 1977 under the authority of the Trading with the Enemy Act are continued under the authority of that Act, but this is so because Congress "grandfathered" those freezing controls when it amended the Act in 1977.

2. (p.3) Page 5. The draft report incorrectly states that the national emergency proclaimed by President Truman in December 1950 as a result of the outbreak of the Korean conflict "has never been terminated." The emergency as such was terminated by Congress in 1976, following the enactment of the National Emergencies Act, but, as noted above, the freezing controls imposed as a result of earlier emergencies were "grandfathered" by Congress when it amended the Trading with the Enemy Act in 1977.

3. (p.9) Page 12. No "encumbrances" can be validly placed against frozen assets without a Treasury license. The Office of Foreign Assets Control (OFAC) presumably has a record of all encumbrances which it has licensed.

4. (p. 19) Page 25. The draft report criticizes OFAC's reliance on private asset-holders to block or freeze assets, and suggests that under certain circumstances OFAC might "perform a caretaking function on behalf of the owners." We know of no legal authority permitting OFAC to assume control of blocked assets or to perform other "caretaking functions."

5. (pp. 19-20) Page 26. It is true that the Trading with the Enemy Act does not contain a provision for civil penalties; it only provides for criminal penalties. (50 U.S.C. App. 16.) However, the International Emergency Economic Powers Act now provides for civil penalties--up to $10,000--for violation of any license, order, or regulation issued under that Act, and these civil penalties are applicable to the Iranian Assets Control Regulations. (See Public Law 95-223, Title II, Section 206(a).)

6. (p.27) Page 36. To our knowledge, freezing controls on dollar assets located abroad were imposed only under the Iranian Assets Control Regulations. We know of no previous instance where freezing controls were extended extraterritorially to dollar accounts maintained in foreign countries.

7. (p.33) Page 44. The domestic banks' inability to pay interest on blocked demand deposits was also due, in part, to the Federal Reserve Bank's Regulation "Q" which prohibits the payment of interest on demand deposits.

8. (p.34) Page 46. The recommendation that the Secretary of the Treasury "negotiate" with asset-holders for the voluntary payment of retroactive interest strikes us as unrealistic. Moreover, we know of no legal authority for such "negotiations."

9. (pp.44-45) Pages 60-64. The draft report refers to a joint Justice-GAO effort which resulted in recovery of $7.9 million in blocked Department of Defense funds. The Office of Foreign Litigation of the Department's Civil Division reviewed its files relating to the blocking and unblocking of the $7.9 million, which constituted a prepayment by the Department of Defense for petroleum products purchased for the Armed Forces of South Vietnam. The report's treatment of that episode is factual, and it accurately describes the role played by the Department in the recovery of that amount and its deposit into the general receipts account of the U.S. Treasury.

We appreciate the opportunity to comment on the report. Should you desire any additional information, please feel free to contact me.

Sincerely,

Kevin D. Rooney
Assistant Attorney General
for Administration

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